OCTOBER 1959

The Controller

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AN INFORMATION-TRANSFER SYSTEM TO ASSIST MANAGERS IN PLANNING AND CONTROLLING

Herbert J. H. Roy

SHORT-TERM INVESTMENT OF SURPLUS CASH

R. N. Stillman

CURRENT TRENDS IN DEPRECIATION ACCOUNTING

Walter R. Staub

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CONCEPT OF MODERN CONTROLLERSHIP
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1. To establish, coordinate and administer, as an integral part of management, an adequate plan for the control of operations. Such a plan would provide, to the extent required in the business, profit planning, programs for capital investing and for financing, sales forecasts, expense budgets and cost standards, together with the necessary procedures to effectuate the plan.

2. To compare performance with operating plans and standards, and to report and interpret the results of operations to all levels of management and to the owners of the business. This function includes the formulation and administration of accounting policy and the compilation of statistical records and special reports as required.

3. To consult with all segments of management responsible for policy or action concerning any phase of the operation of the business as it relates to the attainment of objectives and the effectiveness of policies, organization structure and procedures.

4. To administer tax policies and procedures.

5. To supervise or coordinate the preparation of reports to governmental agencies.

6. To assure fiscal protection for the assets of the business through adequate internal control and proper insurance coverage.

7. To continuously appraise economic and social forces, and government influences, and interpret their effect upon the business.

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COMMENTS ON "RETURN ON WHAT INVESTMENT?"

Editors, THE CONTROLLER:

James Weaver in his thought-provoking article "Return on What Investment?" in the August 1959 issue of THE CONTROLLER raised two very interesting questions:

1. *How should existing excess capacity affect decisions and performance measurement?*
2. *Should excess capacity affect an investment being considered?*

Weaver suggests that an incremental approach be used in both situations. "No allowance is made for past investments since their fixed costs are not affected by the decision on the new project. All present project investment is included regardless of the excess capacity provided."[1]

This paper accepts the basic incremental approach suggested by Weaver, but significantly modifies the interpretation of how to measure and interpret the incremental flows. Used properly the procedures described here will tend to improve operating decisions.

* * *

EXISTING FACILITIES

Let us assume the same situation that Weaver explores, namely an addition to a chemical plant for a new product, where buildings already at the plant are to be utilized as part of the new installation.[2] In considering the desirability of the addition, *should some amount be added to the investment so that the new product will pay for the entire facilities used?* The answer to this question hinges on the "opportunity cost" of using the present facilities.[3]

Actually we can bypass the explicit computation of the opportunity cost by a simple but sound expedient. We are faced with a decision involving mutually exclusive alternatives. For example: We can build the addition; we can let the excess capacity sit idle and wait until a new product appears in the future; or we can scrap the facilities; but we can only do one of these alternatives, not all of them. Using an appropriate rate of discount we can compute the net present value of each alternative; the alternative with the highest net present value being the most desirable alternative.[4] The cost of old facilities, original, depreciated, or adjusted for changes in the price level, do not affect these computations. If there is a better use than the addition being considered, the complete analysis of the cash flows, using the present value procedure, will disclose it.

After the investment is made we will desire to re-appraise the decision. *Should we then consult the accounting records for an allocation of the cost of the old facilities?* This is one possibility which is relatively simple and has the illusion of being objective, thus is more easily defended than the use of alternative procedures. An alternative treatment, suggested by the author in a previous article, may be usable.[5]

FUTURE INVESTMENTS

The second very interesting question asked by Weaver is: *How much excess capacity should one build into a plant?* Weaver does suggest the correct answer. On page 368 he correctly indicates that discounted-cash-flow procedures can study all future cash flows and decide which of

(Continued on page 484)

[1] James B. Weaver, "Return on What Investment?" THE CONTROLLER, August 1959, p. 395.

[2] *Ibid.,* pp. 366-367.

[3] Weaver notes the possibility of using the opportunity cost on page 368, but ultimately suggests ignoring past investment. The term "opportunity cost" represents the measure of the value of the facilities used in the best alternative manner.

[4] See *The Capital Budgeting Decision* by Bierman and Smidt, to be published in March 1960 by the Macmillan Company for an explanation of the present value procedure and the reasons why it will give correct solutions to decisions involving mutually exclusive investments.

[5] See Harold Bierman, Jr., "A Theory of Depreciation Consistent with Decision-Making," THE CONTROLLER, August 1958.

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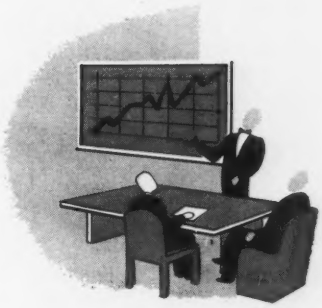
An Information-Transfer System to Assist Managers in Planning and Controlling



Using a high-speed computer to improve communications

Herbert J. H. Roy

SOME FUNDAMENTAL QUESTIONS which managers ask when planning ahead are:

In order to reach a given goal, shall we have more of this particular activity in the future, or less?

Shall we continue the activity at all?

Shall we approve this new activity now being proposed?

And when reviewing past operations, managers pose the inevitable question:

Was performance different from plans; and if so, why?

In both these activities the manager needs good information. Without it, he must rely heavily on memory and intuition or he must chance a greater degree of uncertainty about his decisions working out as he had planned.

Specifically, what each manager needs, when planning and controlling, is more precise information. It has long been apparent that producing this kind of precise information calls for the periodic output of a vast array of numbers—and that the cost of doing this has been great. Only recently, with the availability of high-speed electronic computers, has it been possible to produce such needed numbers at reasonable cost.

The recent acquisition by General Petroleum of a high-speed computer has made it possible for us to experiment with a new information-transfer system. Now, with two years of development and research behind us, we are pilot-testing this system in one of the divisions of our Marketing Department. There is every expectation that, after the bugs have been worked out, we will have a method which (a) provides more precise information on a regularly recurring basis, and which (b) permits two-way communication at all management levels on matters involving management decisions affecting planning and control.

PRECISION AND REGULARITY OF INFORMATION

Our information-transfer system is built upon this well-recognized basic notion: People in an organization are employed in order to accomplish certain goals or results; and these people are provided with the means or resources for attaining such results.

The validity of this notion is fairly obvious, but what is not always so apparent is that there can be different viewpoints between a man and his boss as to what these results and resources really are. For example, it is entirely possible for a Home Office department head, in the course of time, to add to his department's duties minor peripherally related activities. Each added activity extends the radius of his department's affairs, until one day it is evident that he has encroached upon some other department head's specifically assigned territory. In such a situation, the boss has to talk in terms of "let's get back to what is the real function of this department in the total corporate picture."

Also, what is not always so apparent is that while managers do think about the results to be accomplished with certain resources, they are forced to do this in a general way, because usually they are not provided with information so organized that they can identify and evaluate all the results and resources in a given situation.

To take just one example: In the case of a salesman in an oil company, the resources he uses to do his job include, among others, (a) his use of company money to paint service stations, to conduct sales meetings, etc., (b) his use of services provided by others (for example, sales promotion programs, number of deliveries of products to stations in his zone, as requested by him), etc.

Furthermore, results for which he is responsible include, besides such obvious things as sales to customers: Low dealer turnover, recovery of rentals on service stations, collection of overdue payments, maintaining contacts with specified accounts, etc. Yet, traditional accounting systems are not set up to provide these related pieces of information, some of which cannot be expressed in dollars, for each salesman.

Still another idea which is not always apparent is that the exact relationship be-

HERBERT J. H. ROY was appointed to the position of manager, Marketing Research Department of Mobil Oil Company, New York, in May 1959. Prior to that he was manager of the Marketing Organization and Research Department of General Petroleum Corporation, Los Angeles, California—Socony Mobil Oil Company's West Coast affiliate. It was while serving in this capacity that he headed the task force assigned to develop the information-transfer system discussed in this article. He was formerly associated with Booz, Allen & Hamilton and Ebasco Services Incorporated.

tween a given set of results and a given set of resources is difficult to establish. For example, for a given expenditure of resources, what sorts of results should be expected?

All this suggests the need for identifying more precisely the resources and results applicable to a particular position. This, then, is the starting point: Have each man and his supervisor develop and agree upon the nature and size of the job and the quantitative terms in which it can be described.

This basic notion provides the framework for seven corollary viewpoints:

1. There is no sense in holding a man responsible for something over which he has no control. This may be entirely obvious, but how often do departmental P & L statements—on which the manager's activity is evaluated—contain items over which he has no control, or at best, only indirect control of dollar charges made during a given fiscal period? (Example: Allocations of overhead.) In such event, before any significant conversation can take place about "what happened and why," time has to be devoted to identifying the items over which the man actually does exert direct control. In our method, the statement of a man's results and resources includes only those items which both the man and his supervisor agree are within the man's direct control.

2. Results and resources may be expressed not only in traditional dollar terms, but also in terms of physical units. In fact, in some instances, the only meaningful data are the physical units.

3. Where the actions of people in one department are necessarily based on what happens in another department, a channel for transferring information must be provided.

4. There is a difference between the mental processes of planning and controlling; therefore, different kinds of information are needed in each of these two processes. When a person is planning, he has to look in two directions: backward to see where he has been, and forward to see where he is going.

Coming now to control, we believe that the essential element of control is: Finding the point where we are, with respect to the point where we had planned to be, and then identifying the need for taking actions to narrow the gap between the two points. In this sense, in order to exercise control, a manager needs only two kinds of information; namely, where we are and where we want to be. Thus, we recognize a break here with tradition, in that we no longer use comparisons of actual with year-to-date or with last year (or some other previous period) *at the time we are concerned with control.*

5. The planning and control information system must provide the mechanism for doing these things: Comparing results and plans periodically; revising plans periodically; and using a uniform period of time in taking the "forward look."

The particular time periods which should be used for reporting, revising and looking ahead will vary with the requirements of the company. Usually, there is some compromise between what is ideal and what can be afforded. Clearly, the cost of information-transferring increases if more frequent reports are made. Also, the further ahead the manager wants to look "down the road," the larger is the set of numbers which must be put together to deal with the larger number of months in the budget period; and the greater is the cost.

In the case of our pilot test, the decision was made to have monthly reports of attainment compared to objectives, a quarterly opportunity to look ahead, and an established horizon of four quarters in the future.

6. Knowledge of what takes place at the level where sales are being made, where products are being delivered, or wherever the essential actions of the business occur, must get into the information-transfer system so that this knowledge can be used to advantage at each higher level of supervision. Also, it is important that the viewpoints of people at "grass-roots" level are transmitted to persons at other levels, geographically and organizationally. In this way, staff departments can maintain close touch with the manner in which their programs are helping the field people who must put such programs into effect.

Our system provides the opportunity for discussing these events and viewpoints in regularly scheduled meetings and requires the man and his boss to think in quantitative terms about the impact of these happenings. Expressive, but loose, comments, such as "I think this sales program smells," give way to pertinent conversation about "how badly are these events hurting us?" (in terms of accounts lost or sales opportunities missed).

7. Events which will take place in the immediate future are usually the scheduled outcome of plans and decisions made some time in the past. Generally, little can be done to change the course of these events; and whatever modifications can be made are more often best dealt with by the man closest to the point of action. However, events further down the road should be the concern of managers at higher levels.

This suggests that greater reliance should be placed on the local manager for making decisions affecting the period immediately ahead (for example, the next quarter) and that managers at higher levels, with their understanding of the local man's near-term forecast, as well as their own knowledge of a broader horizon of alternatives, should influence plans for longer-range periods (for example, beginning in the second quarter ahead).

Our system, with its continually revised four-quarter look ahead gives managers at each higher organization level the chance to contribute to the planning of actions covering appropriately more distant future time periods.

We come now to the application of these notions of information transfer.

How is this information recorded and transmitted?

This is done by using two types of forms: One is for use in planning ahead (called Provisional Objective Statement); the other is for use in showing attainment

"What's happened to our pioneer spirit? Columbus didn't send a monkey first!"

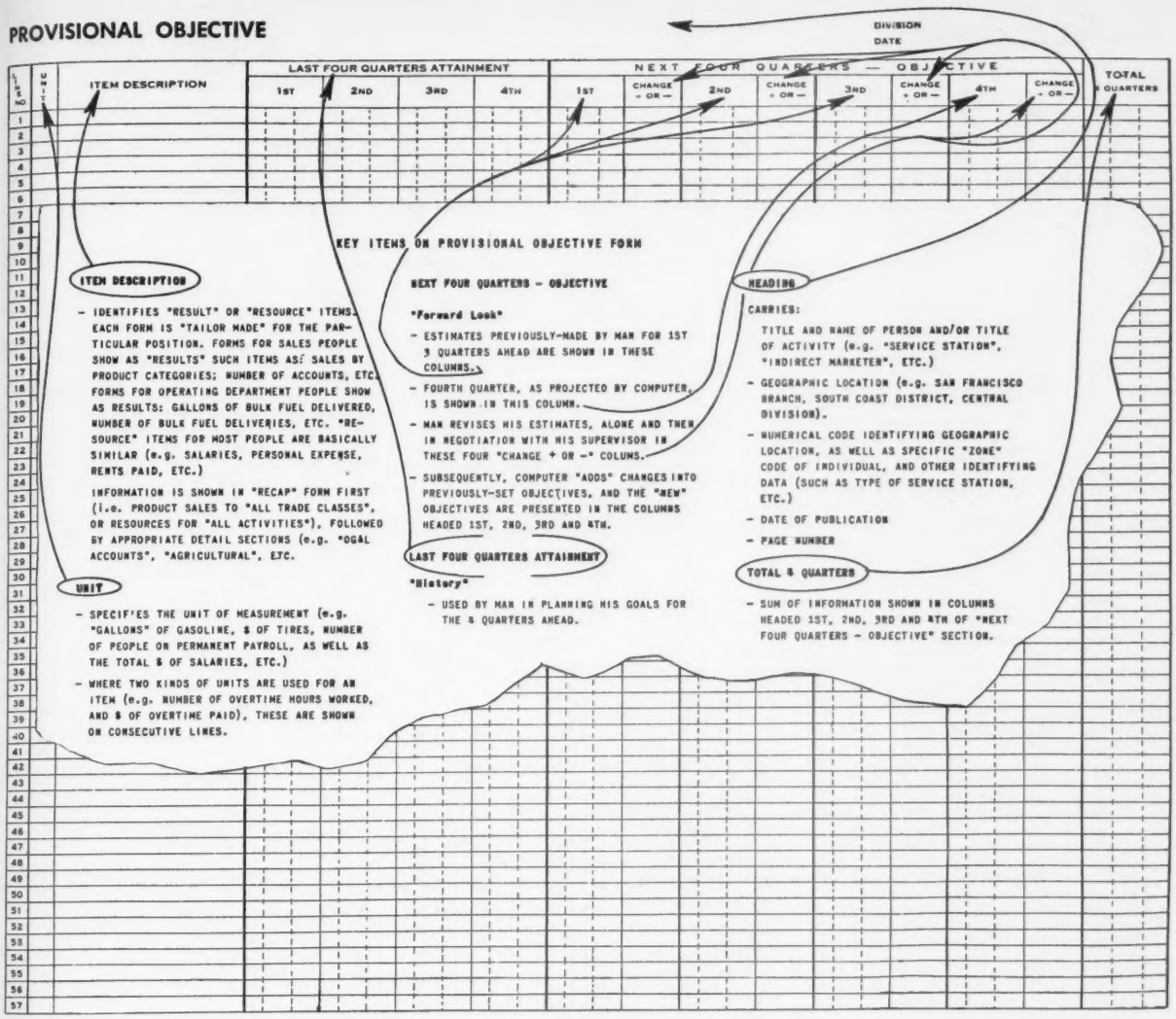

PROVISIONAL OBJECTIVE
DIVISION
DATE
ITEM DESCRIPTION
LAST FOUR QUARTERS ATTAINMENT
1ST
2ND
3RD
4TH
NEXT FOUR QUARTERS — OBJECTIVE
CHANGE + OR —
TOTAL 4 QUARTERS
KEY ITEMS ON PROVISIONAL OBJECTIVE FORM
ITEM DESCRIPTION
- IDENTIFIES "RESULT" OR "RESOURCE" ITEMS. EACH FORM IS "TAILOR MADE" FOR THE PARTICULAR POSITION. FORMS FOR SALES PEOPLE SHOW AS "RESULTS" SUCH ITEMS AS: SALES BY PRODUCT CATEGORIES; NUMBER OF ACCOUNTS, ETC. FORMS FOR OPERATING DEPARTMENT PEOPLE SHOW AS RESULTS: GALLONS OF BULK FUEL DELIVERED, NUMBER OF BULK FUEL DELIVERIES, ETC. "RESOURCE" ITEMS FOR MOST PEOPLE ARE BASICALLY SIMILAR (e.g. SALARIES, PERSONAL EXPENSE, RENTS PAID, ETC.)
INFORMATION IS SHOWN IN "RECAP" FORM FIRST (i.e. PRODUCT SALES TO "ALL TRADE CLASSES", OR RESOURCES FOR "ALL ACTIVITIES"), FOLLOWED BY APPROPRIATE DETAIL SECTIONS (e.g. "OGAL ACCOUNTS", "AGRICULTURAL", ETC.
UNIT
- SPECIFIES THE UNIT OF MEASUREMENT (e.g. "GALLONS" OF GASOLINE, # OF TIRES, NUMBER OF PEOPLE ON PERMANENT PAYROLL, AS WELL AS THE TOTAL $ OF SALARIES, ETC.)
- WHERE TWO KINDS OF UNITS ARE USED FOR AN ITEM (e.g. NUMBER OF OVERTIME HOURS WORKED, AND $ OF OVERTIME PAID), THESE ARE SHOWN ON CONSECUTIVE LINES.
NEXT FOUR QUARTERS — OBJECTIVE
"Forward Look"
- ESTIMATES PREVIOUSLY-MADE BY MAN FOR 1ST 3 QUARTERS AHEAD ARE SHOWN IN THESE COLUMNS.
- FOURTH QUARTER, AS PROJECTED BY COMPUTER, IS SHOWN IN THIS COLUMN.
- MAN REVISES HIS ESTIMATES, ALONE AND THEN IN NEGOTIATION WITH HIS SUPERVISOR IN THESE FOUR "CHANGE + OR —" COLUMS.
- SUBSEQUENTLY, COMPUTER "ADDS" CHANGES INTO PREVIOUSLY-SET OBJECTIVES, AND THE "NEW" OBJECTIVES ARE PRESENTED IN THE COLUMNS HEADED 1ST, 2ND, 3RD AND 4TH.
LAST FOUR QUARTERS ATTAINMENT
"History"
- USED BY MAN IN PLANNING HIS GOALS FOR THE 4 QUARTERS AHEAD.
HEADING
CARRIES:
TITLE AND NAME OF PERSON AND/OR TITLE OF ACTIVITY (e.g. "SERVICE STATION", "INDIRECT MARKETER", ETC.)
- GEOGRAPHIC LOCATION (e.g. SAN FRANCISCO BRANCH, SOUTH COAST DISTRICT, CENTRAL DIVISION).
- NUMERICAL CODE IDENTIFYING GEOGRAPHIC LOCATION, AS WELL AS SPECIFIC "ZONE" CODE OF INDIVIDUAL, AND OTHER IDENTIFYING DATA (SUCH AS TYPE OF SERVICE STATION, ETC.)
- DATE OF PUBLICATION
- PAGE NUMBER
TOTAL 4 QUARTERS
- SUM OF INFORMATION SHOWN IN COLUMNS HEADED 1ST, 2ND, 3RD AND 4TH OF "NEXT FOUR QUARTERS — OBJECTIVE" SECTION.

EXHIBIT I

compared to plans (called Objective Attainment Report). The forms are prepared for each key job. On both these forms, information is grouped according to resources and results—with resources and results data specifically tailored to each job. Also, the items on the Provisional Objective Statement are identical with those shown on the Objective Attainment Report.

On the Provisional Objective Statement, each man quarterly states the results which he expects to accomplish in each of the four quarters ahead, as well as the resources which he feels are needed to accomplish this. (An example of this Provisional Objective Statement is shown as *Exhibit I.*) To help him in this effort, the computer shows on the form actual results for the last four quarters plus figures for the next three quarters (as these were previously estimated by him) plus a projection for the fourth quarter ahead. The man revises these estimates and discusses the estimates with his supervisor.

When agreement has been reached between the man and his supervisor, the revised numbers are sent to the computer center for processing into an agreed-upon total plan. Then, monthly, each man receives a report which shows his attainment compared to the plan. (An example of the Objective Attainment Report is shown as *Exhibit II* on page 454.)

It is, of course, part of the computer's chore to take results and resources for each man and merge or add these into corresponding statements for supervisors, at higher levels—until a results and resources statement is produced for the man at the top level in the department.

In the merging, identity of specific results and resource items is maintained (obviously in more compact summary form at each higher level) so that it is possible quickly to "chase down" explanations asked for topside concerning a particular item.

We now come to the second major aspect in our information-transfer system: two-way communication.

TWO-WAY COMMUNICATION

A key phase of our method is providing the opportunity for a man and his supervisor together to review past performance and to plan ahead—at regularly scheduled times and in an orderly fashion. This is accomplished in the quarterly discussions between the two men. On these occasions:

1. The man and his supervisor are looking together at each part of the man's operation—from the viewpoint of the man. Together, these men are bringing combined knowledge to bear on the problems at hand. Such knowledge can help top managers to be more explicit in delineating problems to be solved by staff departments. Also it can provide top

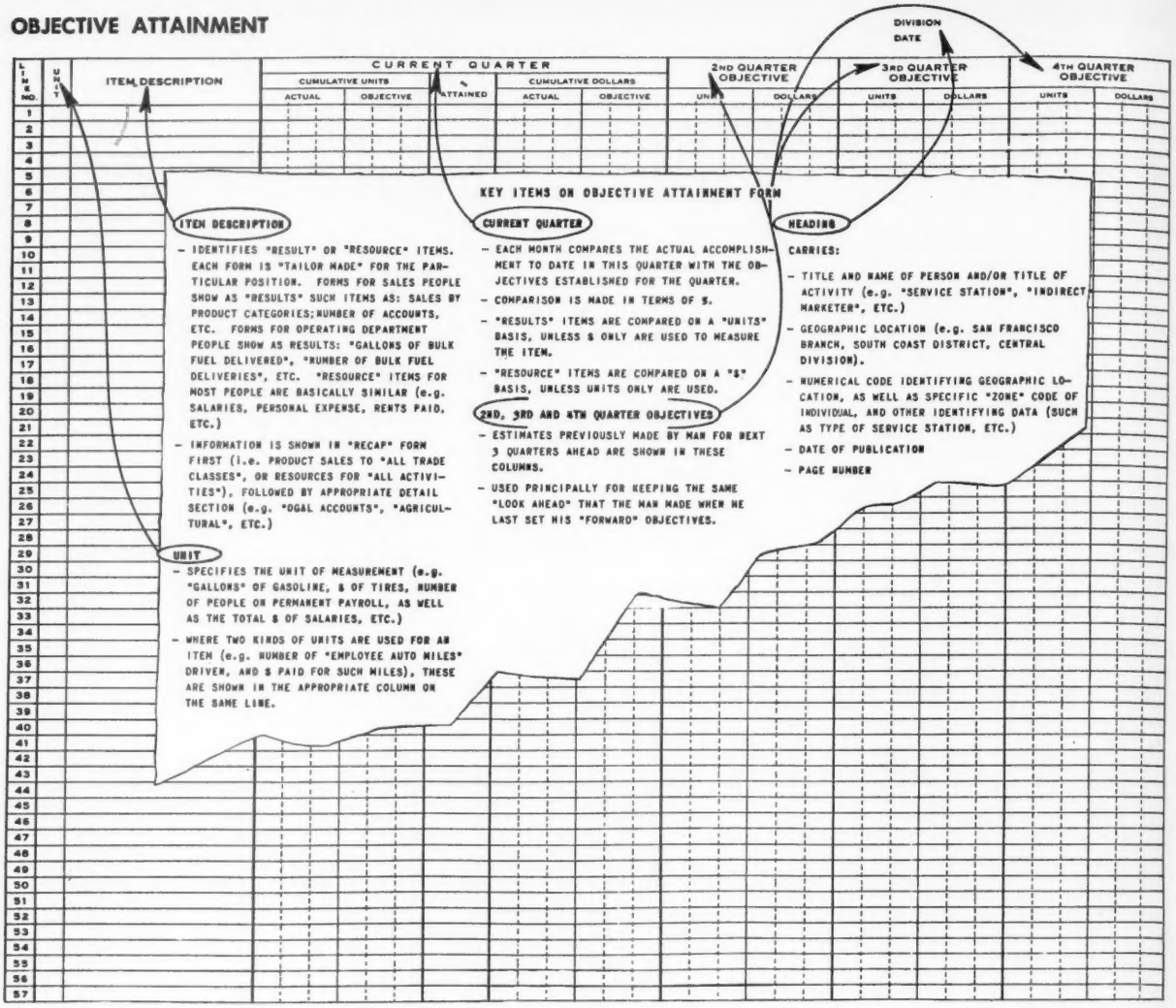

OBJECTIVE ATTAINMENT
DIVISION
DATE
LINE NO.
UNIT
ITEM DESCRIPTION
CURRENT QUARTER
CUMULATIVE UNITS
ACTUAL
OBJECTIVE
% ATTAINED
CUMULATIVE DOLLARS
ACTUAL
OBJECTIVE
2ND QUARTER OBJECTIVE
UNITS
DOLLARS
3RD QUARTER OBJECTIVE
UNITS
DOLLARS
4TH QUARTER OBJECTIVE
UNITS
DOLLARS
KEY ITEMS ON OBJECTIVE ATTAINMENT FORM
ITEM DESCRIPTION
- IDENTIFIES "RESULT" OR "RESOURCE" ITEMS. EACH FORM IS "TAILOR MADE" FOR THE PARTICULAR POSITION. FORMS FOR SALES PEOPLE SHOW AS "RESULTS" SUCH ITEMS AS: SALES BY PRODUCT CATEGORIES; NUMBER OF ACCOUNTS, ETC. FORMS FOR OPERATING DEPARTMENT PEOPLE SHOW AS RESULTS: "GALLONS OF BULK FUEL DELIVERED", "NUMBER OF BULK FUEL DELIVERIES", ETC. "RESOURCE" ITEMS FOR MOST PEOPLE ARE BASICALLY SIMILAR (e.g. SALARIES, PERSONAL EXPENSE, RENTS PAID, ETC.)
- INFORMATION IS SHOWN IN "RECAP" FORM FIRST (i.e. PRODUCT SALES TO "ALL TRADE CLASSES", OR RESOURCES FOR "ALL ACTIVITIES"), FOLLOWED BY APPROPRIATE DETAIL SECTION (e.g. "OGAL ACCOUNTS", "AGRICULTURAL", ETC.)
UNIT
- SPECIFIES THE UNIT OF MEASUREMENT (e.g. "GALLONS" OF GASOLINE, $ OF TIRES, NUMBER OF PEOPLE ON PERMANENT PAYROLL, AS WELL AS THE TOTAL $ OF SALARIES, ETC.)
- WHERE TWO KINDS OF UNITS ARE USED FOR AN ITEM (e.g. NUMBER OF "EMPLOYEE AUTO MILES" DRIVEN, AND $ PAID FOR SUCH MILES), THESE ARE SHOWN IN THE APPROPRIATE COLUMN ON THE SAME LINE.
CURRENT QUARTER
- EACH MONTH COMPARES THE ACTUAL ACCOMPLISHMENT TO DATE IN THIS QUARTER WITH THE OBJECTIVES ESTABLISHED FOR THE QUARTER.
- COMPARISON IS MADE IN TERMS OF $.
- "RESULTS" ITEMS ARE COMPARED ON A "UNITS" BASIS, UNLESS $ ONLY ARE USED TO MEASURE THE ITEM.
- "RESOURCE" ITEMS ARE COMPARED ON A "$" BASIS, UNLESS UNITS ONLY ARE USED.
2ND, 3RD AND 4TH QUARTER OBJECTIVES
- ESTIMATES PREVIOUSLY MADE BY MAN FOR NEXT 3 QUARTERS AHEAD ARE SHOWN IN THESE COLUMNS.
- USED PRINCIPALLY FOR KEEPING THE SAME "LOOK AHEAD" THAT THE MAN MADE WHEN HE LAST SET HIS "FORWARD" OBJECTIVES.
HEADING
CARRIES:
- TITLE AND NAME OF PERSON AND/OR TITLE OF ACTIVITY (e.g. "SERVICE STATION", "INDIRECT MARKETER", ETC.)
- GEOGRAPHIC LOCATION (e.g. SAN FRANCISCO BRANCH, SOUTH COAST DISTRICT, CENTRAL DIVISION).
- NUMERICAL CODE IDENTIFYING GEOGRAPHIC LOCATION, AS WELL AS SPECIFIC "ZONE" CODE OF INDIVIDUAL, AND OTHER IDENTIFYING DATA (SUCH AS TYPE OF SERVICE STATION, ETC.)
- DATE OF PUBLICATION
- PAGE NUMBER

EXHIBIT II

managers with the information needed by them in evaluating the programs developed by these staff departments. This is in contrast to having programs developed topside which fail to take into consideration the facts. Because both the goals (results) and required costs (resources) are being considered simultaneously, it is possible to estimate the effects of one upon the other.

Also, it should be noted that the supervisor in no way loses the opportunity to stimulate people to greater effort. He has merely to be a little "tougher" in raising sights at the time he and his people are setting goals.

2. At the same time, both men are able to identify the need for making exceptions to established procedure.

3. Furthermore, when looking at a course of action which is actually going to be undertaken, the planners must usually consider these two aspects: What we would like to accomplish and what can actually be done in a given situation. If the plan is dominated by the "what we would like to accomplish" viewpoint, results could be far short of expectations (an example would be sales quotas established without reference to whether or not there was a chance of attainment). If the plan is dominated by the "what can be done" viewpoint, the results may be more than are wanted (as for example, in a period of short product supply, a salesman may be impelled to sell more product than is available) or results may be less than are needed (an example might be the effect of a salesman not realizing the present availability of, and economic feasibility of using, hitherto restricted resources).

4. While the negotiation is going on, the two men have before them a written statement which is to become their agreement of the job to be done. The fact that the statement is quantitative and that each item is well defined and well understood, minimizes semantic or other types of misunderstandings. Furthermore, because the objective statements are reasonably complete descriptions of agreements previously reached, both men can keep their discussions within the same frame of reference, and thus avoid situations where two persons would be basing their comments on differently understood assumptions.

5. By the time these discussions have been completed, both men have reached an agreement. In effect, the employe is saying that in a given period of time he will undertake to accomplish a certain job, provided he is given the particular tools needed.

As we said earlier, the key purpose of this information-transfer system is to provide significant information to the man

(Continued on page 476)

Short-Term Investment of Surplus Cash

R. N. Stillman

Surplus cash is no longer a temporary phenomenon for the typical big corporation and the considered investment of these funds is a major responsibility of the company's financial manager

THE YEARS since the outbreak of World War II have been marked by a sizeable, but irregular, growth in the cash funds of America's large nonfinancial corporations. This growth has been the result of a combination of factors, including an expanding industrial output and an inflationary climate with record corporate earnings, conservative dividend payment policies, and increased long-term borrowing.

The executive managers of many major corporations have become increasingly desirous of maintaining a level of cash funds which is in excess of the foreseeable operating needs of the business. The extra cash is regarded as a reserve which permits latitude and rapid decision, within limits, in matters involving plant expansion, acquisitions of other companies, acceleration of research or advertising activities, and the like. These excess liquid resources also represent a hedge against the vicissitudes of a business slump or of other unforeseen emergencies. To a considerable extent, the growing penchant for long-range planning is supported by the confidence which management derives from the availability of substantial quick assets.

In recent years, the financial managers of the country's large corporations have given increasing attention to the effective use of cash funds, not overlooking the profitable employment of cash which is expected to be surplus for varying periods of time. The sophisticated approach and techniques which many corporate investors now employ can be attributed to the widening recognition that surplus cash is no longer a temporary phenomenon for the typical big corporation and that the considered investment of these funds is a major responsibility of the financial manager.

Among corporations which do not segregate the functions of cash management and related treasury activities from controllership responsibilities, it often falls within the province of the controller to invest cash funds which are in excess of the immediate operating needs of the company. My purpose in this article is to describe the more important media which are available for short-term investment and to provoke thinking which may prove helpful in achieving protection of principal and a satisfactory income from surplus funds.

FRAMEWORK OF AUTHORIZATION

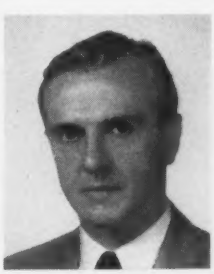
A short-term investment program is usually carried out within the framework of an authorization from the board of directors of the company. The authorization will spell out the type of investments which the controller (or other designated executive) may make—such as U. S. Treasury bills or other Treasury obligations, U. S. agency issues, municipal or other tax-exempt securities, time deposits, commercial paper, etc. The authorization should clearly state the maximum authorized length of maturity for specific investments, should place a dollar limitation on investment in various types of securities in certain instances, should state what confirming action—if any—is required from one or more other executives to authenticate investment transactions, and should be clearly worded to leave no doubt as to the extent of authorization which the board has granted.

The board's authorization will necessarily reflect the collective or individual thinking of the board members and will certainly be tempered by their collective or individual confidence in the controller or other designated executive. The latter, for his part, should endeavor to secure an authorization which will be tailored to the company's best interests. A narrow and restrictive authorization—confining investment to U. S. Treasury bills, for example—may prove satisfactory if relatively small amounts of excess funds are available only at intermittent intervals or if the time available for supervision of investments is limited. As larger amounts of cash become available for longer periods of time or if increased attention can be devoted to investment policy, greater latitude should be sought.

THE ADMINISTRATION OF A SHORT-TERM INVESTMENT PROGRAM

The amount of time and size of staff required for administration of a short-term investment program will vary in accordance with the degree of emphasis that management chooses to accord to the function, with the number and complex-

R. N. STILLMAN holds a B.S. degree from Roanoke College and has had postgraduate work at the Graduate School of Business, New York University. A CPA (Ill.), he started in public accounting with Touche Niven & Co. in 1939; he was with the U.S. Government—cost analyst and contract termination (1942-46); cost accounting supervisor with Time, Inc. (1946-47); and chief accountant, later controller with Wesco Waterpaints, Inc. (1947-52). From 1952-59 he has been manager, Accounting Staff and later assistant controller of Stauffer Chemical Company, New York.



ity of banking relationships, with the scope and diversity of the portfolio, and with the extent of sophistication which is sought to be applied in making switches, repurchase agreements, etc. Portfolios ranging upwards to $50 million, and perhaps substantially larger, can often be effectively handled with seven or eight manhours per week of supervisory and analytical effort, plus two or three clerical manhours, provided that investment is limited to conventional types of securities. This effort should be supported by close liaison with the investment staff of one or two major banks and by well-maintained relationships with government bond specialists, commercial paper brokers, and money brokers. The corporate investor may well consider the desirability of sharing the load by furnishing copies of the portfolio and cash forecast highlights to the selected bank or banks.

The largest corporations, with far greater amounts of surplus cash funds than exist in medium-size companies and with ramified and complex cash collection channels, will devote correspondingly more time to the investment function in order to develop adequate effectiveness.

A necessary guide to a sound investment policy is a systematic and reasonably accurate cash forecasting program. Without cash forecasts, investment of surplus funds becomes a chance affair. An unduly conservative cash forecast will tend to cause the investment of funds in securities with an unnecessarily short maturity and with a consequent low yield. An overly optimistic cash forecast will lead to the forced sale of securities prior to their maturity or prior to their planned sale, with possible impairment of principal.

Supplementing the cash forecast, the investor must determine for his guidance the minimum adequate amount of cash funds required for the operating needs of the business and for support of proper and necessary banking relationships. All funds in excess of this minimum amount —which amount may vary periodically according to seasonal or other requirements —become, by definition, surplus. Attention should be given to the methods which are to be adopted for purposes of making these surplus funds available for investment with the least possible delay. The use of post-office box and wire transfer arrangements with depository banks will usually be desirable.

SETTING A TARGET

The controller, or other executive, who is supervising a portfolio of short-term investments should establish for himself and his company an objective for each fiscal period. Although various alternatives are available, it seems realistic to set a "target" by reference to prevailing short-term interest rates. The objective can be set week-by-week, as an example, by using the yields which the U. S. Treasury realizes on its weekly offerings of 91- and 182-day Treasury bills. The first 20 offerings in 1959 brought an average yield of 2.85% for 91-day bills and 3.20% for 182-day bills. The controller could at this point have established a yield of 3.55% as his objective, by hypothetically assuming that surplus funds are systematically invested in continuing equal amounts in 182-day Treasury bills which yield 3.20% if held to maturity, but which are sold at the end of 91 days when they yield only 2.85% if held to maturity, with the funds immediately reinvested in a new issue of 182-day bills yielding 3.20%, and so forth. An objective computed in this manner can be updated each week as the new issues of Treasury bills are auctioned. The target set by this formula is an ideal, at least for U. S. Treasury bill investment and trading, and the investor will likely find his actual results falling short of the target unless he has expanded his portfolio to include securities having a higher yield than Treasury bills.

It is apparent that corporations having a relatively constant amount of surplus cash funds during any given period should achieve better investment results than those companies with cash balances which fluctuate according to seasonal or other requirements. Also, the company with a proportionately large amount of surplus cash should realize a better return than a company having a proportionately smaller excess, since the former is usually in a position to safely invest in longer maturities and to employ income-enhancing techniques. In 1959 many corporate investors may find it difficult to achieve satisfactory investment results because of their holdings of securities purchased in 1958 at unusually low yields which prevailed during much of that year.

GETTING A GOOD YIELD ON INVESTMENTS

A few words on the subject of yield are warranted. Although a good yield on investments is a desirable objective, safety of principal should certainly be the primary aim. During periods of declining interest rates it is easy for the investor to be lured into placing his funds into increasingly longer maturities, with the objective of maintaining the eroding yield on his investments. This practice can prove a snare, as was demonstrated in the aftermath of the speculative government bond market which existed in 1958. Funds invested during periods of declining interest rates tend to be "locked in" when the trend is reversed. The investor may find himself with the unhappy alternatives of maintaining his position in these longer-term securities at a lower interest rate than that which becomes available as rates rise, or of abandoning his investment position with a loss of principal. Generally, the investment position should become increasingly short-term as interest rates approach the end of a declining phase, despite the urge to commit oneself in an entirely contrary manner. Hindsight is superior to foresight in all investment affairs, and the approaching end of a decline in interest rates often defies prediction. The investor can best rely on his bankers' advice, on informed published opinion, and on his own restrained impulse.

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U. S. Treasury issues

The most liquid form of short-term investment is the U. S. Treasury bills, which are currently auctioned weekly in 91- and 182-day maturities. In addition, the Treasury has recently initiated a series of longer bills auctioned at quarterly intervals. All these bills are issued on a discount basis under competitive and noncompetitive bidding, and at maturity their face value is payable without interest. Following their original issuance, the bills are actively traded at discounts from face value which reflect the pattern of ebb and flow of short-term investment funds. Except during periods of rapidly ascending interest rates, cash can be invested in U. S. Treasury bills for as short a period as one week with a reasonable certainty that interest earned (represented by the reduced amount of discount from face value) will exceed the spread between bid and asked prices which the investor must absorb on a "round-trip" (purchase and sale). It is also possible to enter into repurchase agreements on Treasury bills, assuring the investor of a specific yield to a desired maturity date. Advantageous yields can frequently be negotiated, particularly with nonbank security dealers.

If surplus cash funds are available for an extended period of time, the yield on U. S. Treasury bills can often be increased by "riding the curve." This practice is based on the consistently higher yields which are available in the Treasury bills of more distant maturity. For example, using the yields cited in the earlier example, the practice of dollar-averaging investment in 91-day Treasury bills might produce an average yield of 2.85% and investment in 182-day Treasury bills might yield 3.20%, whereas riding the curve by systematic sale of 182-day bills after 91 days with reinvestment in a new issue of 182-day bills might yield about 3.55%. Numerous variations of this practice can be improvised, but they must be used warily during periods when interest rates are rising.

The U. S. Treasury also accomplishes a substantial portion of its financing needs by its offerings of bonds, notes, and certificates. They are usually issued originally at par with interest payable semiannually or at other periods at a specified rate. These securities are attractive to corporate investors who seek a higher income yield than is available from U. S. Treasury bills. The higher yield on bonds, notes, and certificates reflects their somewhat lower degree of marketability as compared to the bills. Generally, investment in bonds, notes, and certificates should be made only if there is reasonable assurance that they can be held for a sufficiently long time to virtually assure that their maturity or approaching maturity will dispel any likelihood of loss of principal. At times these securities sell at discounts from par value, thus providing attractive capital gains possibilities.

Many U. S. Treasury issues, in addition to the bills, lend themselves to repurchase agreements. A repurchase agreement involving a U. S. Government bond, for example, may be made between a corporate investor looking for a stable income from surplus cash funds and a strongly capitalized security dealer, who is enabled to borrow at a favorable rate.

Among its bill and certificate offerings the Treasury includes issues which are designated as "tax anticipation" securities. These issues have a stated maturity date which may be six to eight days following March 15, June 15, September 15, or December 15, but the securities can be used by a corporate investor for payment of federal income taxes on the 15th. The securities are accepted for payment of taxes at their face value (plus accrued interest in the case of certificates) with the corporation, in effect, receiving credit for interest earned to the stated maturity date. The investor should be aware that the use of tax anticipation issues for payment of taxes in place of drawing a check against his bank or banks will deprive the banks of a credit to their tax and loan accounts with the U. S. Treasury. The controller, or other executive, must consider the effect on his established banking relationships which might result from a sudden change of practice in this regard. On the other hand, the bank will be the beneficiary of a credit to its tax and loan account, if tax anticipation securities are purchased through the bank at date of original issue. Generally, however, tax anticipation issues will be available to the corporate investor at a more favorable interest rate in the secondary market shortly following the original issuance of the securities.

The corporate investor should keep in mind that his choice of investments may have a material effect on balance sheet presentation. The U. S. Government obligations described in the several preceding paragraphs may usually be offset against the federal income tax liability, as stated in Accounting Research Bulletin No. 43 of the American Institute of Certified Public Accountants. Other short-term investments, including U. S. agency issues, are generally to be reported on the asset side of the balance sheet, not being acceptable as offsets to the tax liability.

U. S. Government agency issues

A number of U. S. Government agencies issue bonds and notes which are attractive to corporate investors. These agencies include the Federal Intermediate Credit Bank, Federal Land Bank, Federal Home Loan Bank, Banks for Cooperatives, and Federal National Mortgage Association. Their securities have become of increasing popularity with investors, although they still sell to return a slightly higher yield than U. S. Treasury issues. The higher yield on U. S. agency issues reflects their slightly lesser marketability and the absence of a direct U. S. Treasury obligation on their behalf. They are construed to be moral obligations of the U. S. Treasury, however, since it is virtually unthinkable that the Federal Government would permit impairment of the credit-standing of any of its agencies.

Tax-exempt securities—such as local housing authority issues which are collaterally secured by agreement with the U. S. Public Housing Administration, as well as municipal and state securities—constitute another area of investment opportunity for the corporation with surplus funds. These securities are exempt from federal taxes on income, and frequently sell at yields which provide a higher after-tax income than do U. S. Government securities. Increasing awareness of this differential has tended to narrow the spread and reduce the advantage of the tax-exempts to corporate investors in recent years. The investor is advised to look to his bank for advice as to the credit standing of the issuers of these securities.

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Current Trends in Depreciation Accounting

Walter R. Staub

Management now thinks about depreciation accounting but there is no discernible trend toward actual adoption

IN THE HISTORY of accounts and accounting, depreciation for a long time was given little recognition. At the turn of the century it was perhaps more often ignored than otherwise. Probably the first general acceptance of depreciation as an element of cost coincided with enactment of the income tax laws. Even then, the idea persisted in the minds of many that capital assets for all practical purposes might properly be considered as having unlimited existence. This was especially so in those segments of our economy which had large investments in fixed assets, composed of many units which were maintained and replaced with regularity so that the plant, as a whole, was preserved without loss of efficiency. In addition, there existed a not inconsiderable body which, while not necessarily contesting the validity of the general concept of depreciation, objected to its introduction into accounts on the grounds that too great an element of conjecture was involved. There were, of course, also differences of opinion as to the preferable method of its calculation; these, though, were of secondary importance. In time, however, there was general agreement on the need for depreciation accounting and, within broad limits, on methods of its application.

The subject has, however, never ceased to be a matter of continuing interest to accountants, and within recent years considerable attention has been focused on the question of the adequacy of periodic depreciation charges as computed under present conventions. I am referring, of course, to the impact of present inflationary forces upon depreciation which is computed on the basis of historical costs that, because of inflation, are no longer representative of current costs. This aspect of depreciation accounting is of such great current interest that I want to devote what I am going to say to it and I believe that the increasing amount of attention given in recent years justifies its being considered as a trend in thinking—although there is no discernible trend toward actual adoption.

RISING INTEREST OCCASIONED BY INFLATION

Shortly after the close of World War II, business became concerned because costs of capital replacements far exceeded the original cost of assets replaced. In the then belief that these excess costs were occasioned by inflationary influences which might be expected to be temporary in nature, the belief arose that they should be charged off in the year of their occurrence; however, this idea never achieved acceptance to any degree—perhaps because of the objections of the accounting profession, but more likely because it was soon admitted that inflation was with us to stay.

The concern regarding the disparity between current and historical cost however persisted and has given rise to continuing questions as to whether depreciation charges based on historical dollar costs provide a realistic measure of the charge which need be made against income for the exhaustion of facilities in order to arrive at a useful concept of periodic net income. Those asking the questions and suggesting thoughtful alternatives include many leaders in the fields of business and accounting.

In particular, they stress that profits as now reported are grossly overstated because generally accepted accounting principles do not recognize as an expense the difference between depreciation charges based on historical cost and the current cost of replacing obsolete plant. Maintenance of capital, considered in the sense of productive capacity, is placed in jeopardy. Taxes paid on this alleged overstatement of profits are viewed as capital levies. It has been argued that modernization and maintenance of plant has therefore been deterred which in turn has led to a deterioration of our country's competitive position in the world.

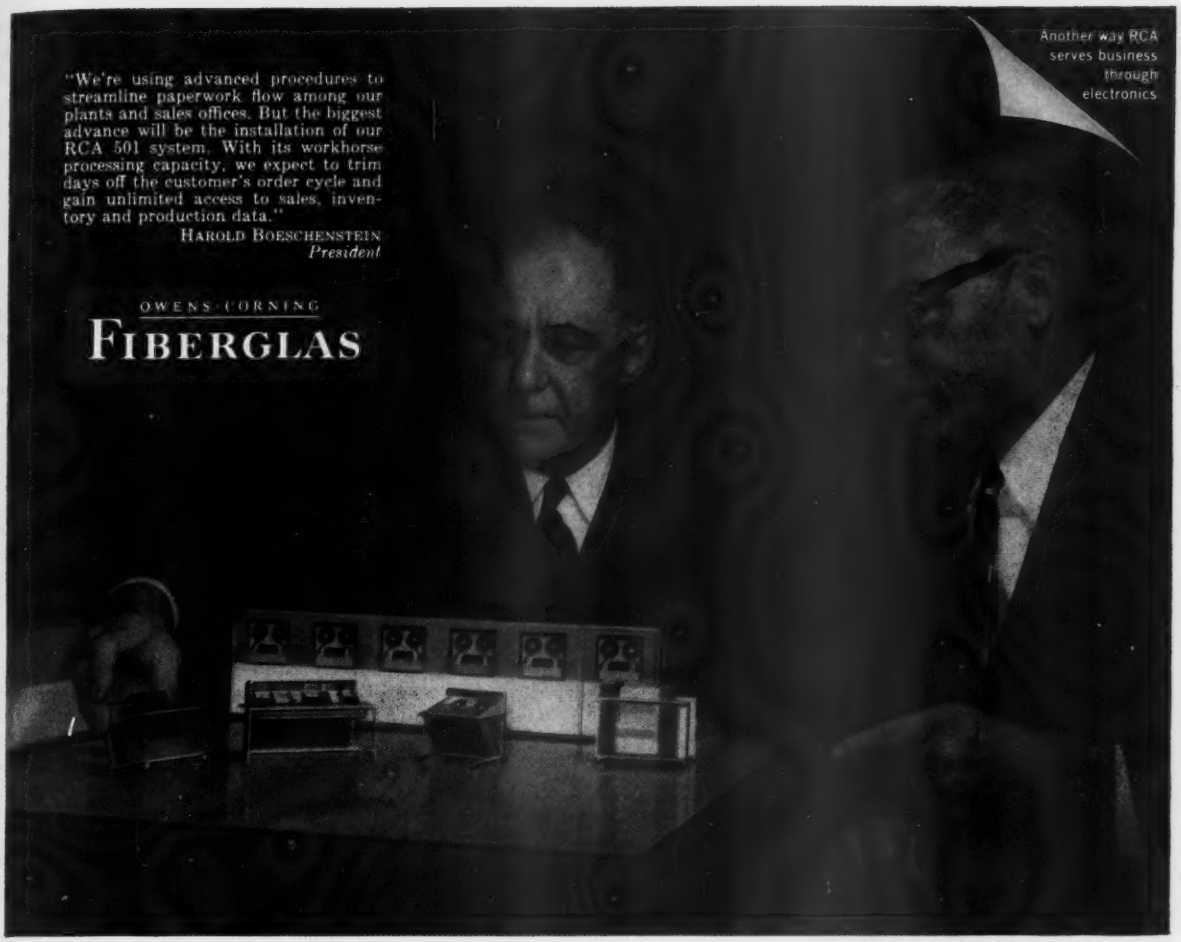
While I feel the intensity of the attack has tended to vary somewhat with variations in the cost of living index, it now appears that many consider continuing inflation as inevitable. In their opinion, the long-term trend in the purchasing power of the dollar will continue to be in but one direction—down.

CURRENT VALUATION ADVOCATES

Those who are concerned with the consequences of adherence to historical cost depreciation believe that financial statements would be more useful if depreciation charges, and possibly the related

(Continued on page 460)

WALTER R. STAUB is a partner in the firm of Lybrand, Ross Bros. & Montgomery, certified public accountants, and is chairman of the firm's technical Committee on Practice. He holds CPA certificates in a number of states and is a member of the American Institute of Certified Public Accountants and a member of other accounting organizations. He served as a member of the American Institute's Committee on Accounting Procedure from 1954 through 1959. This paper was presented before the regional conference of Controllers Institute of America at Richmond, Virginia.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fixed assets, were stated in terms of current valuations. They suggest that:

1. Investors require more information than accounting on a historical cost basis can provide;
2. Establishment of a dividend rate consistent with maintenance of capital on a purchasing power basis would be facilitated;
3. In wage negotiation, the company's ability to pay would be more fairly presented; and
4. In rate-making cases the utility's economic return would be more readily apparent.

They also point out that management should have available current costs on which to base its decisions. Since depreciation is often a significant part of product costs it is important that it be stated at current price levels. Such adjusted cost data are needed as an aid to management in setting product manufacturing and selling policies. This argument stresses the greater significance of current dollar costs as compared with costs arising from prior price levels.

There is no doubt as to the magnitude of the problem. Approximately 10% of the Gross National Product, or some $40 billion, is currently being invested annually in new plant and equipment. A survey of some 750,000 corporate income tax returns filed for 1955 indicated that plant account represented the largest single investment of corporate funds—three times the investment in inventories.

The aggregate annual depreciation charge against income has been estimated to currently approximate $15 billion to $16 billion. This total depreciation charge is expected to increase, reflecting continued plant expansion coupled with a trend toward greater mechanization and a speed-up in obsolescence resulting from technological improvements. The dollar amounts are huge when measured on a national scale and of relatively equal significance for many individual companies.

Against this background of tremendous plant investment and related depreciation provision, we find a dramatic degree of inflation in the post-war period, as indicated by a 50% rise in the Consumers Price Index. It is this inflation which has led to our current depreciation controversy.

REPLACEMENT DEPRECIATION ADVOCATES

Since initial attention to this matter was occasioned by the fact that accumulated depreciation did not meet the cost of replacing depreciated facilities it was somewhat to be expected that first consideration would be along the lines of charges which accumulate amounts equal to such replacement costs. A survey by the American Institute of Certified Public Accountants in 1958 indicates that this is still the objective of many of those who question the adequacy of historical cost depreciation. However there is an increasing number who recognize that such replacement depreciation probably is an unreachable goal since continuing deterioration of the dollar creates continuing deficiencies that as a practical matter cannot be made up out of current revenues.

Those who do not hold for replacement depreciation but who, nonetheless, believe that historical cost depreciation is currently unsatisfactory, point to what they consider to be the internal inconsistency of financial statements which, in effect, reduce to a common denominator expired costs representing expenditures of differing purchasing power. They liken the problem to that encountered in the preparation of consolidated financial statements where different currencies are involved. They also point out that the same incongruity was recognized in the case of inventories but that it has in large measure been overcome by the adoption of the LIFO method of costing. They further conclude that since other material asset items are, by reason of turnover, reasonably expressed in terms of current dollars, the only remaining area in need of attention lies in fixed assets. These do not view departure from historical cost as a departure from cost, itself, but as being in the nature of a step to employ costs of like value. They believe there is no longer any validity in the accounting postulate that changes in the value of the monetary unit may be disregarded.

The foregoing statements briefly indicate the views of those who believe that a departure from depreciation based on historical cost is called for. I shall endeavor, with equal brevity, to state the feelings of those who hold to the opposing view.

First, let me say that, as far as I have been able to discern, all are in agreement that the changing value of our monetary unit affects the significance of historical cost depreciation, and that as a consequence, resultant net income must be considered in a different light than would be the case if a stable monetary unit had been our experience. Those who presently adhere to historical cost depreciation concede that under conditions of inflation depreciation accumulations are less a measure of the dollar cost of prospective replacements than if the monetary unit were stable, but they contend that replacement is not the intended purpose of depreciation provisions. They also consider that inflation has not yet proceeded to the point that original dollar costs have lost their significance. In general they believe that the adoption of adjusted depreciation methods gives rise to problems which call for further consideration and entails possible disadvantages and that these factors presently outweigh the merits of its use in basic financial statements.

*

Committee on Accounting Procedure of the American Institute of Certified Public Accountants (1953):

The committee, therefore, reaffirms the opinion it expressed in Accounting Research Bulletin No. 33, December 1947:

Any basic change in the accounting treatment of depreciation should await further study of the nature and concept of business income.

The immediate problem can and should be met by financial management. The committee recognizes that the common forms of financial statements may permit misunderstanding as to the amount which a corporation has available for distribution in the form of dividends, higher wages, or lower prices for the company's products. When prices have risen appreciably since original investments in plant and facilities were made, a substantial proportion of net income as currently reported must be reinvested in the business in order to maintain assets at the same level of productivity at the end of a year as at the beginning.

Stockholders, employes, and the general public should be informed that a business must be able to retain out of profits amounts sufficient to replace productive facilities at current prices if it is to stay in business. The committee therefore gives its full support to the use of supplementary financial schedules, explanations or footnotes by which management may explain the need for retention of earnings.

Study group sponsored by the American Institute of Certified Public Accountants (1952):

Upon this point it would seem that in the longer view methods could, and should, be developed whereby the framework of accounting would be expanded so that the results of activities, measured in units of equal purchasing power, and the effects of changes in value of the monetary unit would be reflected separately in an integrated presentation which would also produce statements of financial position more broadly meaningful than the orthodox balance sheet of today. It is believed that statements

PROFESSIONAL CONSIDERATION OF THE SUBECT

This question has been the subject of intensive study by accountants since shortly after the close of World War II. In 1947 the Committee on Accounting Procedure of the American Institute of Certified Public Accountants issued a statement on the subject—Accounting Research Bulletin No. 33. This bulletin was reconsidered and, without change of substance, was reissued in 1953 as part of Accounting Research Bulletin No. 43.

In addition, the Institute, with the aid of a grant from the Rockefeller Foundation, caused the organization of a study group on Business Income to consider the impact of inflation on business income. This group, after several years of study, caused its findings and conclusions to be published in 1952 in a monograph entitled "Changing Concepts of Business Income."

Another well-recognized accounting organization, the American Accounting Association, also studied the question of the effect of inflation upon financial statements and issued a statement on the subject in 1951 which was repeated in 1957 in "Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements."

Because the conclusions of these groups represent the considered opinions of informed and intelligent men who had carefully and thoroughly considered the problem, I believe it worthwhile to cite them.*

On the one hand the proponents of adjusted depreciation do not deny the usefulness of the cost concept, given a reasonably stable monetary unit. On the other hand, those holding the opposite view nonetheless infer by their reasoning that under some conditions they would deem adjustment of historical cost to be appropriate. It appears therefore that the difference in views is based largely upon varying weight given specific problems and consequences attendant upon use of current cost methods rather than to stem from any disagreement on a matter of broad principle. I therefore believe it important to consider each of these specific matters.

THE NEED FOR RESTATEMENT OF ASSETS

It is my impression that most of those who favor continuance of depreciation on the basis of historical cost appear to feel that if a change to a "current cost" basis were to be made, a concurrent restatement of the related asset accounts would be necessitated. At least some of those who advocate the adoption of current cost depreciation, believe that plant may continue to be carried in the balance sheet at historical cost with deduction of depreciation based thereon.

In addition to historical depreciation, they propose a supplementary annual charge to income with a corresponding credit to an account for property replacements and substitutions, to be classified with the stockholders' equity. I cannot agree with the latter opinion. In the absence of related adjustment of the balance sheet, a discrepancy would arise between it and the income statement which would have the effect of relegating the balance sheet to a position of practically no importance. Also, since the significance of the income statement depends to a considerable extent upon viewing it in relation to the balance sheet this discrepancy would to a large extent, also tend to impair the usefulness of reported income.

PRICE INDICES

Many of the proponents of price-level adjustments suggest the use of indices to accomplish the purpose. This appears to be motivated both by reasons of practicality and from the belief that the use of indices contributes to objectivity and, assuming the adoption of the same or similar indices by companies, to greater comparability. Further they believe that it relates adjustments more to price-level changes and less to reproductive costs of specific assets. While indices which are based on large aggregates may be an imperfect measure of change when applied to a specific group of assets I certainly would not object to their use if it were to be decided to adopt current depreciation since the alternative would be periodic appraisals which, it appears to me, are impractical if adjustments are to be made at frequent intervals.

OBJECTIVITY

Many who are opposed to price-level adjustments point to loss in objectivity in the determination of reported amounts. Undoubtedly there would be some loss of objectivity, since I can imagine no standard of accounting measurement which would be as objective as the actual cost resulting from an "arm's-length" transaction. However, objectivity in many aspects of accounting has been in the nature of a compromise with other considerations and, personally, I do not view this as an insurmountable objection. It seems to me that measures for adjustment could be evolved which would provide a reasonable degree of objectivity.

UNIFORMITY IN FINANCIAL REPORTING

Over the years, considerable progress has been achieved in developing greater uniformity and standardization in financial reporting. In the United States, fixed assets are stated at cost and depreciation is based on cost with but few exceptions. Any substantial change in the basic finan-

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of business income in which revenues and charges against revenue would be stated in units of substantially the same purchasing power would be significant and useful for many of the purposes for which income determinations are commonly used, if not also in reports upon stewardship.

The problem of presenting both the most generally useful income determination and a fully significant statement of financial position would doubtless present difficulties, but probably none which the highly developed accounting techniques of today could not solve.

For the present, it may well be that the primary statements of income should continue to be made on bases now commonly accepted. But corporations whose ownership is widely distributed should be encouraged to furnish information that will facilitate the determination of income measured in units of approximately equal purchasing power, and to provide such information wherever it is practicable to do so as part of the material upon which the independent accountant expresses his opinion.

American Accounting Association (1957):

Management may properly include in periodic reports to stockholders comprehensive supplementary statements which present the effects of the fluctuation in the value of the dollar upon net income and upon financial position.

(a) Such supplementary statements should be internally consistent; the income statement and the balance sheet should both be adjusted by the same procedures, so that the figures in such complementary statements are coordinate and have the same relative significance.

(b) Such supplementary statements should be reconciled in detail with the primary statements reflecting unadjusted original dollar costs, and should be regarded as an extension or elaboration of the primary statements rather than as a departure therefrom.

(c) Such supplementary statements should be accompanied by comments and explanations clearly setting forth the implications, uses, and limitations of the adjusted data.

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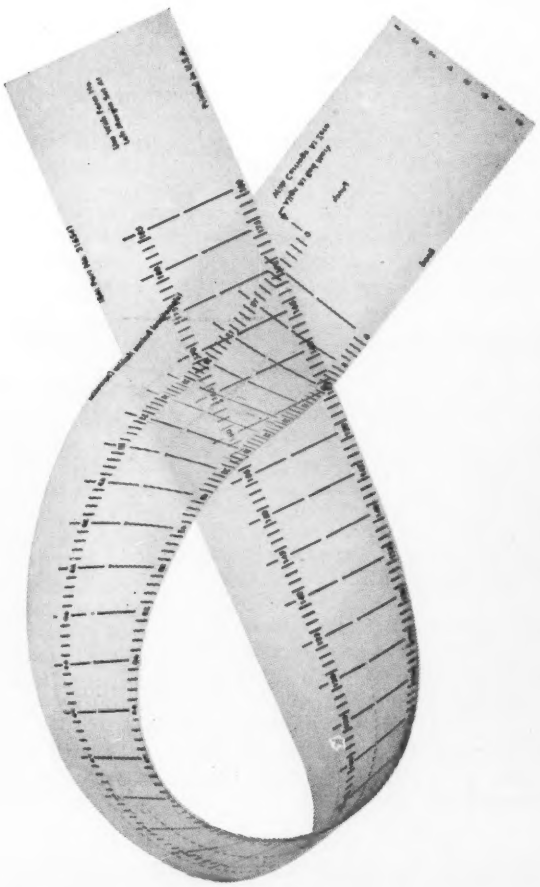

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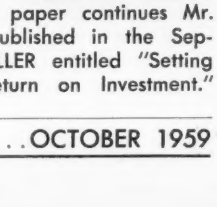
Harvey O. Edson

How to determine the correlation between costs and investment within the framework of a manufacturing operation

THE NEED for carefully determined prices is essential for effective profit-planning under today's competitive conditions. It is equally true that arbitrary percentage mark-ons which do not relate the factors of investment to the product price are unlikely to meet a standard of careful determination. The technique of relating investment factors to profits (return on investment), while well developed for the measurement of the total corporate result, leaves much to be desired in formulating pricing policy. If ROI is to be used effectively in planning as well as in measuring over-all results, a means of identifying the investment factors for sound pricing decision becomes essential. Failure to provide such bench marks will limit ROI's practical value as well as become a point of frustration to the line executive anxious to meet management's expressed ROI objectives. To accomplish this end, the principles of analysis discussed under "Setting a Standard for Your Company's Return on Investment" (THE CONTROLLER, September 1958) must be extended to provide a basis for product-pricing. It is the purpose of this paper to outline the further application of ROI analysis in the pricing area.

The term "price" as discussed herein refers to a target price which will provide a given rate of return. In application, such a target price may be more or less than the actual selling price. This is expected, and effective management control requires that differences be analyzed to determine the strategy needed to maximize ROI.



HARVEY O. EDSON, a CPA (Ill.), attended Northwestern University; is a graduate of the Executive Program, University of Chicago; and is a member of Controllers Institute of America. He was formerly assistant treasurer and controller of Kellogg Switchboard and Supply Company, Chicago, Ill., and controller of the Illinois Tool Works, of the same city; he is now with the New York office of Haskins & Sells, Management Advisory Services staff. This paper continues Mr. Edson's thinking in his last article published in the September 1958 issue of THE CONTROLLER entitled "Setting a Standard for Your Company's Return on Investment."

Although the procedure outlined herein is of necessity an oversimplification, the principles suggested will in some manner be applicable to all company operations. The initial stages of analysis required to identify the investment factors to products are necessarily detailed. However, in establishing target prices based on the desired rate of return, a set of logical correlations of the investment factors to products will be developed. Such knowledge properly applied should pay off in better planning and better decision-making, resulting in greater profit. An intimate knowledge of investment relationships to production costs may reveal many areas where the usage of investment (turnover) is too low. Such corporate introspection can be a real eye-opener, particularly if managerial follow-up on past investment decisions has been less than complete.

Essentially the management of business for profit requires that the elements of investment employed be as carefully planned and coordinated as the elements of sales and costs. The application of ROI to your pricing problem effectively provides management with a practical tool with which to meet this responsibility.

In applying ROI to product-pricing, the cost and investment elements for individual products or product groups must be identified. From such detailed data logical correlations between the factors of cost and the factors of investment can be determined. To be properly applied both the fixed and current investment elements must be separately identified and individually related to the product cost factors, i.e., cash, receivables, and inventories to factory costs, the fixed investment to the fixed costs. Let us consider some of the ways to determine these correlations within the framework of a manufacturing operation.

Translating the Current (Variable) Investment to Product Cost

The following table identifies the elements of current investment and their relationship to the elements of product cost.

Current Investment	*Investment Factor Determined by:*	*Related Cost Factor*
Cash	Company policy as to cash balances (Usually 15-30 days cash disbursements)	Total cash cost of product (Total costs less depreciation provisions)
Accounts Receivable	Terms of sale (i.e., 30 days net)	Selling price
Inventories:		
Finished Goods	Planned inventory levels	Inventory cost
In Process and Raw Materials	Planned inventory levels	Inventory cost

(Continued on page 466)

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The necessary computations and data to translate and correlate the current investment to the cost factor are demonstrated in the following example:

Given for Product A:

1. Sales terms—Net 30 days.
2. Company policy to maintain 20 days cash requirements at all times.
3. Finished Goods inventories to be maintained on three-months turn-over basis.
4. In Process and Raw Material inventories to be maintained on a one-month turn-over basis.
5. Cost Factors Product A:

	Per 1000	%
Factory Cost	$272.00	80.%
Selling and Administrative	68.00	20.%
Total Costs	$340.00	100.%
Less depreciation	34.00	10.%
Total Cash Costs	$306.00	90.%

6. Desired ROI = 25%.

Since return on investment ratios are always expressed at annual rates, all time factors must be expressed as a percentage of the year for conversion into a common ratio to total costs thus:

Current Investment Element	*Period Required*	*Cost Factor*			*Conversion to Annual Investment Factors (expressed as a ratio to total costs)*
		% of 1 yr.		*Ratio to Total Cost*	
Cash	20 days	5.5% X	Cash Cost	90%	= 4.95
Accounts Receivable	1 month	8.33 X	Selling Price	125%*	= 10.41
Finished Goods	3 months	25.00 X	Factory Cost	80%	= 20.00
In Process and Raw Materials	1 month	8.33 X	Factory Cost	80%	= 6.66
	Current Investment Requirement				= 42.02
	(expressed as a ratio to total cost)				Use 42%

* The 25% mark-up used here is a knowledgeable approximation. The precise calculation of this mark-up can be determined by algebraic computation. In most applications such estimates will suffice occasioning but little distortion of the final result.

The factor of 42% expresses the relationship between the unit cost and the current investment requirements, i.e., for each dollar of unit cost, a current investment of 42¢, on the average, will be needed. It follows that the pricing additive needed will be the product of the current investment requirement (42%) times the desired rate of return (25%) times the unit cost of the product ($340.00 per M) thus:

.42 X .25 X $340 = $35.70 (per M).

The $35.70 (per M) is the pricing additive needed to provide a 25% return on the current (variable) investment employed.

Generally, the current investment ROI pricing factor can be determined and applied satisfactorily on a product group basis. By grouping those products with reasonably similar billing terms and inventory characteristics, the number of individual rates and computations can be held to a minimum.

Translating the Fixed Investment to Product Cost

In establishing a unit-pricing factor for the fixed investment all fixed asset values must be assigned, through a process of allocations, to product centers (individual machines or cost centers) and then translated into a rate per machine hour, direct labor hour or dollar, or other suitable base. The identification and allocation of the fixed investment to the product line is not generally so easily defined as the application of the current investment. In complex, multiproduct situations where product cost distributions reflect less than precise definition of the cost factors, the allocation of the fixed investment will also be limited. In such instances, it may be impracticable to attempt to assign the fixed investment to the individual product line. Where such complexity exists, the ROI analysis for pricing purposes may be of greater value if such limitations are recognized and the fixed assets are assigned on a product group basis.

The allocation of fixed investment will generally follow methods used in the distribution of indirect and service expenses in establishing rates for overhead absorption. In undertaking analysis in this area, the analyst would be well advised to study each stage of the allocation process carefully, recreating and adapting the techniques to the particular and special characteristics of the productive processes in each individual division of the company. Keeping in mind that there is no established or uniform analytical approach which is valid under all circumstances will help to prevent premature and erroneous conclusions.

All fixed asset values must first be classified into homogeneous categories by departmental location. If the existing accounting structure does not readily provide this information, it will be necessary to analyze the fixed assets to develop departmental and group totals before allocation to cost centers can be undertaken. The analysis and allocation of fixed assets is intended to assign in a logical manner all fixed investment to the direct productive equipment by cost center and to the administrative and sales divisions. In effect, the fixed investment is "boiled down" to a few group totals which can be converted into the loading factors to be applied on machine hours (or other suitable base) in the pricing formula to provide a predetermined rate of return on the fixed investment.

Assume, for purposes of illustration, that the total fixed investment of $1 million of the company producing our hypothetical product A, has been allocated to four direct production machines and to the administration and sales divisions as follows:

Machine #1—$	132,000
2—	330,000
3—	198,000
4—	247,500
Administrative	42,500
Selling	50,000
	$1,000,000

The Fixed Investment in Productive Equipment

To correlate the fixed productive investment to product lines (in this example to product A) factors for the operating level

(Continued on page 468)

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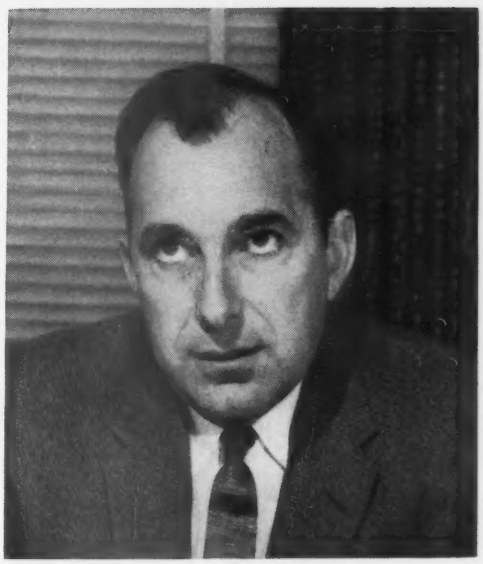

KENNETH C. SMITH,
Vice President and Treasurer, Jantzen, Inc.

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and the production rates of the machines (capacity factors) on a product line basis are required.

For product line A the following are given factors:

1. Product A is produced on machines #1 and #2, the product being first processed on machine #1 and completed on machine #2.
2. The unit capacity of machine #1 is 2000 per hour. Excess capacity of this machine cannot be utilized on other products.
3. Unit capacity of machine #2 is 1000 per hour.
4. Unit sales are estimated at 3300M for the year.
5. Desired ROI = 25%

Translating the fixed investment into a factor per M units of product A would follow thus:

	Total Fixed Investment		*Annual Machine Hours Operating Level*		*Investment Per Machine Hour*		*Product Machine Output Per Hour*		*Fixed Investment Per M Units*
Machine #1	$132,000	÷	1,650	=	$ 80.00	÷	2,000	=	$ 40.00
Machine #2	330,000	÷	3,300	=	100.00	÷	1,000	=	100.00
									$140.00

The factor of $140.00 represents the fixed investment per M units of product A. It follows that the pricing additive needed per M units will be the product of this fixed investment factor per M units ($140.00) times the desired rate of return (25%) thus:

$140.00 X .25 = $35.00 (per M)

The $35.00 per M units factor is the pricing additive needed to provide a 25% return on the fixed productive investment employed.

NOTE: The foregoing example is an obvious oversimplification. In practice it would be unnecessary to compute unit factors in a situation wherein individual machines are identified to the exclusive production of a single product line. However, the technique illustrated provides the basis for extending these principles to multiproduct conditions. For example, assuming that other product lines would also be produced on machines #1 and #2, the investment allocation would incorporate the production rate and budgeted operating level for all lines and the individual factors for each product would be computed in a similar manner.

"I never touch the stuff except on special occasions like a wedding or a party or the bills being too high or a row with my wife or the kids driving me crazy or something"

The Fixed Investment in Selling and Administrative Equipment

In our example, the fixed assets assigned to the selling and administrative functions total $42,500 and $50,000 respectively (4.25% and 5% of the total fixed investment). This is characteristic of the typical manufacturing situation wherein these asset categories are relatively minor in importance. Under similar conditions in actual problem situations, practicality might dictate that these amounts be combined with the productive machine investments and applied against units produced. Such treatment would eliminate the need to develop this additional pricing factor.

The purpose in providing a separate loading factor in this illustration is to direct attention to an area of analysis which may have significance in some applications (i.e. distribution and administrative cost analysis). In those situations wherein the fixed investment and costs of distribution are major factors, or when the assets and costs related to these functions vary significantly on a product line basis, a careful determination of the selling and administrative investment factors by products would be essential to the determination of accurate target prices.

In order to apply the S & A fixed investment to unit costs, a correlation between the S & A cost and investment factors must be established. For the purpose of our example, it is further given that S & A expenses for all products total $462,500. By relating the value assigned to the S & A fixed investment ($92,500) to total S & A expense ($462,500) a ratio of 20% is computed. This factor of 20% expresses the relationship of the total S & A fixed investment to each dollar of S & A cost. The S & A pricing additive needed will be the product of fixed investment factor (20%) times the desired rate of return (25%) times the S & A costs identified to the product ($68.00 per M) thus:

.20 X .25 X $68.00 = $3.40 per M

The $3.40 per M factor is the pricing additive needed to provide a 25% return on the fixed S & A investment.

Determining the Target Price on Product Line A

Using the three factors which have been developed to this point, the product target price to yield a 25% return on investment would be computed as follows:

Total Product A Costs and ROI Factors Computed For:	(Per M) $340.00
(a) Current (variable) investment	35.70
(b) Fixed (productive) investment	35.00
(c) Fixed (S & A) investment	3.40
Target Price—(25% ROI)	$414.10

By projecting product A's unit price, cost and investment factors at the budgeted level of 3,300 M units for the year the 25% return on investment is demonstrated, thus:

Sales at $414.10 per M	= $1,366,530	100.0%
Costs at $340.00 per M	= 1,122,000	81.1
Operating Profit, before taxes	= $ 244,530	17.9%
Investment Employed:		
Current (variable) at 42% of total costs	= $ 471,240	
Fixed-Productive Equipment	= 462,000	
Fixed-S & A (allocated as 20% of S & A expense)	= 44,880	
Total Investment Employed	= $ 978,120	
25% on Investment Employed	= $ 244,530	

General Considerations in Applying ROI to Product-Pricing

The process of correlating investment to unit costs should reveal the need for the effective control of the elements of investment. A straight mathematical approach, applied to an exist-

ing experience which does not provide for the effective control of the variable elements of investment, is likely to result in target prices which are excessive or show little relationship to the actual selling price. For example: In establishing the variable investment factor for product A, certain time requirements were given for cash, accounts receivable and inventory items. Without control, these factors could conceivably reflect twice the time experiences stated which would result in a unit-pricing factor for the current investment of twice the amount computed, thus:

	As Given In Example	*Without Control*
Cash	20 Days	40 Days
Accounts Receivable	1 Month	2 Months
Finished Goods	3 Months	6 Months
In-Process & Raw Material	1 Month	2 Months
Price Additive Per M Units	$35.70	$71.40

This higher factor would increase the unit target price almost 9% to $449.80, for a desired return of 25%. Assuming that the $414.10 price was the actual selling price, the ROI would be depressed to less than 17%.

Control of investment is as significant to economic profit as is the control of production costs. The following comments point up some of the more obvious control requirements:

Current Investment:

Cash—Cash balances equal to two or three weeks' requirements are usually adequate. Balances in excess of these periods should be considered excess cash and excluded in the factoring process.

Accounts Receivable—The terms of sale should be in keeping with competitive practices for the product line. Management consideration to revision of policy should be requested whenever the terms are unusual or more lenient than your competition. Unsatisfactory collection experience should not be reflected in the rate.

Inventories—In establishing the factor for inventory levels, appraise the turn-over experience. This is an area where standards should be established on a reasonably "tight" basis. Attainable and economic inventory standards should be reflected in your pricing factor. Excesses due to inadequate control should be excluded in the factoring process. Planned overstock resulting from price hedging or production scheduling is normally decided on the resulting savings involved. If these decisions are sound, the savings will more than offset the additional investment costs.

Fixed Investment—In many complex processing and multi-product plants the development of detailed unit factors may prove to be impractical on an individual product line basis. The extent to which the allocation of investment should be made must be determined in relationship to the complexity of the process and products of the individual company. In extremely complex operations it may be that the identification and allocation of fixed assets in product groups will be more feasible.

In interpreting the ROI pricing factor for the fixed investment employed, the capacity level used to convert the investment into units of production is most significant. If usage of equipment is low and this experience is reflected in the base applied to your pricing factor, the factor may result in unrealistic target pricing. Such situations should be analyzed. Corrective management action in such cases would be implied.

In conclusion:

Do not undertake an ROI analysis for unit-pricing unless your cost system provides reasonably accurate data by individual product lines.

Do not assume that your ROI pricing approach provides an absolute. Your data are primarily an extension of analysis to provide better bench marks. These can only serve as check points and to substantiate judgments in your pricing policy.

Applied in proper context, your analysis should lead to the more effective planning control and use of the factors of investment, which are prime objectives of good management.

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Vol. 2 lists pertinent statutes alphabetically, creates a descriptive, easy-to-understand title for sections carrying no heading—excerpts from federal statutes and regulations (one part), excerpts from provincial statutes and regulations (ten parts)—all arranged for quick reference.

* Vol. 1 ($10.00) covers U. S. federal requirements. Vol. 3 (to be published) covers states of the U. S.

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Personnel, Inventory and Billing Savings Cited by EDP Users

SUBSTANTIAL SAVINGS through personnel displacement were indicated by several of the 11 companies analyzed in a survey of benefits resulting from the use of electronic data-processing equipment by Lybrand, Ross Bros. & Montgomery. Two companies with high-volume applications have saved over $1 million each over the life of the system, and a smaller company whose activities were highly decentralized is saving in excess of $250,000 annually through decentralization.

Many allied benefits have accrued in the personnel area due to the fact that an EDP system converts a large part of clerical activity from a variable to a fixed cost. An increase in the volume of activity accounts for important benefits which include adaptability of the computer to volume increases, lessening influence of salary increases, and improved employe relations.

In addition to personnel displacement, the survey shows benefits through the use of a computer in improved management control, reduced expense due to faster billing, and improvement of competitive position.

Improved management control is seen in two areas, according to the report—inventory reduction (seven companies reported substantial decreases in inventory investment) and production control. While most companies have entered various phases of the production control problem, total integration seems to be the aim of most users and important reductions in time necessary for production cycles have been cited.

Reduced billing time from 33 days to 20 hours was reported by a military equipment systems supplier and an annual net savings of $645,000 realized.

In practically all 11 companies surveyed, management has felt a need for better, faster reports to improve the company's competitive position. In some cases this has been achieved in reporting by exception. On the other hand, some companies have found that new reports and faster reports result in improvements. Through the use of a computer, budgetary limits which prevented older systems from providing timely reports are eliminated.

Company Jury Duty Policies

A large number of companies have taken long strides in recent years toward enabling their workers to perform jury duty without personal loss, according to a survey by the National Industrial Conference Board. The NICB surveyed 363 companies and found that 302 of them have a specific plan for guarding supervisors against financial loss while serving as jurors. In actual practice, the NICB notes, some of the 61 companies that say they have no plan may pay their supervisors for the time they serve as jurors without regarding this as a formal procedure. A few companies report they have not formulated a plan for compensating supervisors absent on jury duty because "the situation has never arisen."

An earlier NICB survey, covering non-supervisory personnel, revealed that almost 53% of the hourly employes in 276 companies and 86% of the salaried employes in 287 companies lost no income while they served on juries. As a rule, jury fees received by hourly employes were deducted from their regular pay, but salaried employes more often were permitted to keep the fees in addition to the regular pay.

As in the case of the rank-and-file salaried employes, the new survey finds supervisors usually come out ahead when they serve on juries. In 199, or about two thirds, of the 302 companies with specific plans, supervisors receive their full salary from the company in addition to whatever fees they are paid as jurors.

In 74 of the 302 firms, about 25%, supervisors are either paid the difference between their company salary and the jury fees, or they are given full salary but are required to turn over their jury fees to the company.

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Richard L. Ganzi
President
Paul B. Mulligan & Co. Inc.

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* The original work papers for the development of these figures are on file at the offices of Paul B. Mulligan & Co., Inc., 405 Lexington Avenue, New York City, and are available for review upon authorization of The Traveletter Corporation.

(Signed) Richard L. Ganzi, President
Paul. B. Mulligan & Co., Inc.

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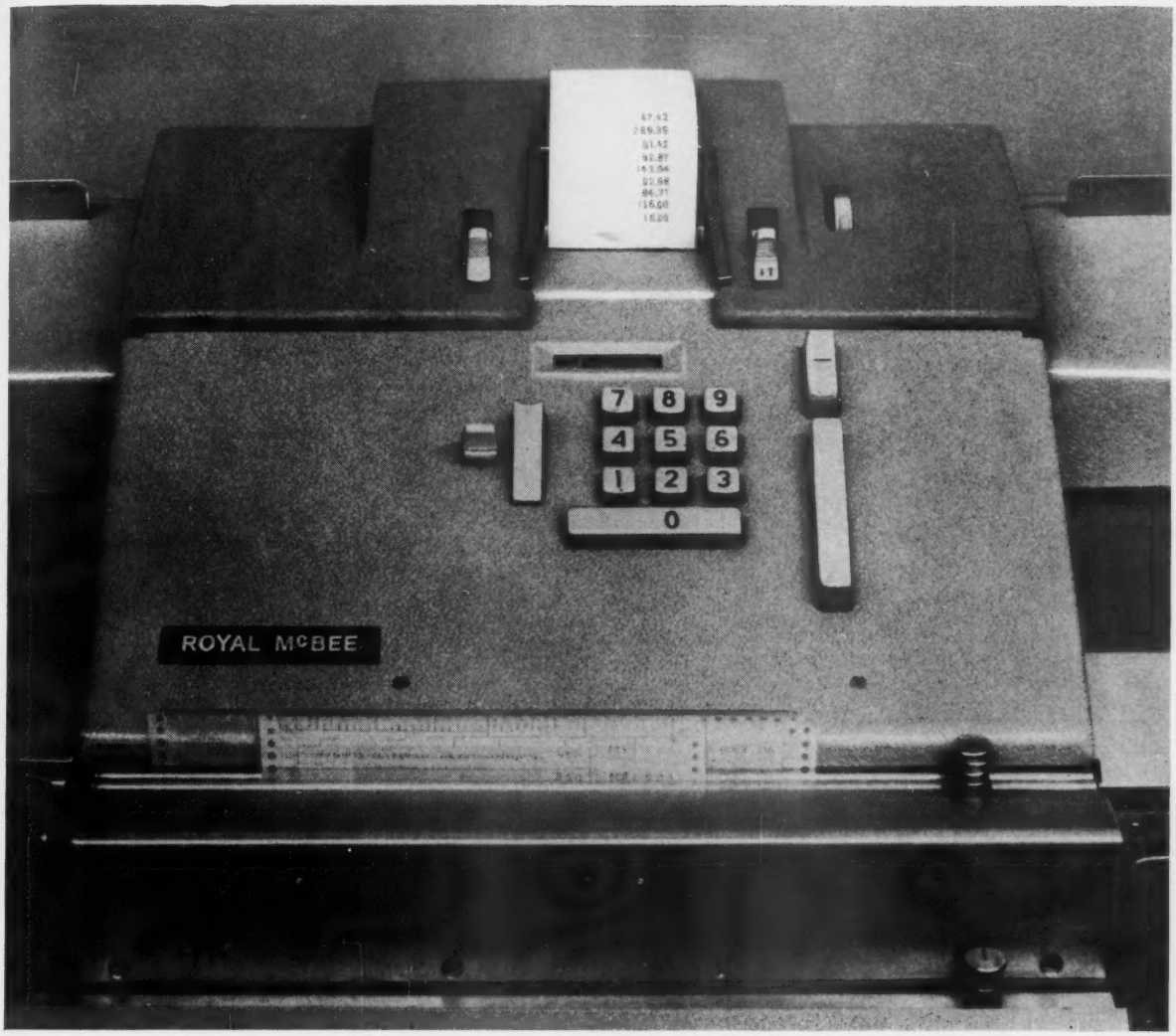

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Paging the New Books

FINANCIAL ANALYSIS FOR MANAGEMENT*

By Ronello B. Lewis

Reviewed by ELY FRANCIS
Assistant Controller
Radio Corporation of America
New York

This book is written for the operating executive, the controller, the financial analyst, the instructor and the student. It is the sequel to "Accounting Reports for Management" by the same author. It contains an intelligent presentation of basic data essential to the operation of all types and sizes of business. It is written in a language familiar to the technician and understandable to the layman.

This book covers the following major topics:

1. Capital expenditures and rate of return.
2. Purchase or acquisition of a going business.
3. Mergers.
4. Adding or dropping product lines.
5. Interdivisional pricing.
6. Leases and leasebacks versus ownership.
7. Planning the source of funds.

The highlights of these seven subjects, which concern every business, every member of top management, and staff people who must interpret, forecast and recommend, are summarized below.

CAPITAL EXPENDITURES AND RATE OF RETURN. The author recommends that the incremental approach be adopted when calculating the rate of return on proposed capital additions. This involves starting with the investment and profits *before* reflecting any changes. The next step is determining the investment and profits *after* reflecting proposed changes. The difference between the two investments and profits is the incremental change; by dividing the incremental investment into the incremental profit the rate of return can be determined.

An analysis of proposed capital expenditures must answer four basic questions:

How much money must be spent immediately?
What is the total investment?
What is the effect on operations?
What is the total of nonrecurring expenses and losses?

The following ten rules should be applied to the problem of capital expenditures and rate of return:

1. Use as practical business approach which is easy to understand. Avoid the complicated, theoretical methods which can easily lead to misinterpretation and distrust of the analysis. The author explores the investor's method but recommends against it because of its many shortcomings.
2. Adopt the incremental approach.
3. Use gross investment as a base, preferably gross tangible assets.
4. Use investment at the beginning or end of year, rather than average investment.
5. Use book net profit after taxes.
6. Employ the existing accounting format, not a specialized approach.
7. Consider tax savings from accelerated amortization as a source of capital.
8. Write off nonrecurring expenses or losses.
9. Treat replacements as two separate transactions—the liquidation of existing properties and the capital addition.
10. State results conservatively and on a consistent basis.

The author presents a completely documented series of illustrations on how to evaluate the present situation versus several alternatives.

PURCHASE OR ACQUISITION OF A GOING BUSINESS. In seeking answers to problems in this area it is important to get a complete set of facts. It is impossible to proceed with the purchase or acquisition of another company in an intelligent manner without adequate information.

The minimum data consist of actual results for the past ten years and a projection for the next five years; this means having profit and loss statements showing significant income, cost and expense categories and balance sheets with the major elements reflected.

A detail study should support the financial summaries and should:

1. Analyze product line sales, prime costs, indirect factory costs, gross margins and major expense items.
2. Cover important balance sheet items, such as reconciling capital additions and retirements and the reserve for depreciation with the net fixed asset balances.
3. Examine the stockholders' equity.
4. Analyze the surplus accounts.
5. Produce a flow-of-funds statement.

MERGERS. A merger involves no sales price. There is no profit or loss, and no tax consequence. It is simply a pooling of assets of the two companies. A merger is merely a basis for the exchange of shares of stock.

The following information should be prepared:

1. A summary of sales and earnings for each company for the past five years and the next five years.
2. A "pro forma" statement indicating the probable savings had the merger occurred five years earlier. A similar statement showing possible future savings on a merged basis is also required.
3. A past and future summary of stockholders' equities, earnings, dividends and market values on a before and after merger basis.
4. A summary of the basis for and advantages of the merger from the standpoint of earnings, dividends, book values and market values for each company before and after the merger.
5. The balance sheet contributions of each company.
6. A flow-of-funds projection for the merged company five years ahead.

ADDING OR DROPPING PRODUCT LINES. The author feels it is mandatory to employ the incremental approach in reach-

* *Published by Prentice-Hall, Inc., Englewood Cliffs, N. J. $25.00.*

ing a sound decision in this area. This requires assigning to a product line only those costs and expenses controlled by it. The author is unalterably opposed to prorating to a product line a cost or expense which will not be eliminated with the dropping of the product.

A number of illustrations are provided to indicate how errors of judgment result when the incremental approach to product profitability is ignored.

INTERDIVISIONAL PRICING. There are four methods for transferring product from one division of the company to another division:

1. Selling price. This method is most frequently used. The major advantage is that the transferring division benefits as much from transactions with other company divisions as with outside customers. At the same time, the receiving division pays no more than it would from an outside supplier. Operating results of both divisions are accurately stated.
2. Cost. This is defined as labor, material, overhead, warehousing and shipping expenses of the transferring division. This provides little incentive to the seller.
3. Cost with a transfer back of some portion of profit. This method raises the recurring problem of what is the proper amount of profit to transfer back to the selling division.
4. Combination method, where the selling division transfers at a sales price, the buying division receives at cost, and the corporate staff eliminates the difference.

This provides each division with the maximum profit incentive, but it is completely misleading.

LEASES AND LEASEBACKS VERSUS OWNERSHIP. There are three types of transactions in the category of long-term leases and leasebacks:

1. The payment of rent.
2. The sale and leaseback.
3. The buy, sell, and leaseback.

The author thoroughly explores the sale and leaseback in reply to the conventional argument that it is unwise to "tie up capital in bricks and mortar."

The author points out that the interest on leaseback deals far exceeds that on long-term debt; that leasebacks provide no salvage value, and that the tenant has no equity at the termination of the lease.

The advantages of leasebacks are also reviewed, such as:

1. Profit returns may greatly exceed the high-interest factor.
2. It can become a source of capital when other avenues are closed.
3. Leasehold liabilities, unlike debt, do not appear on the balance sheet.
4. Internal conditions may favor proposals which do not drain available funds.

(Continued on page 474)

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Operating Electronic Equipment: position of the EDP machine center in the corporate organization structure, operating the EDP machine center, program maintenance and revision.

Relations with the Manufacturer: preliminary study, training of programmers and machine operators, physical installation, debugging time, acceptance tests, maintenance.

Some Unresolved Matters and Some Thoughts on the Next Five Years: programmer evaluation, automatic coding, change to newer equipment, aid to management, new areas of application.

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The proper method for evaluating the cost of leasebacks versus the cost of ownership is fully documented and illustrated.

PLANNING THE SOURCE OF FUNDS. Profit control can only be attained through proper planning. This involves the projection of operations and earnings or the budgeted profit and loss; the projection of assets, liabilities and net worth or the projected balance sheet; and the projected flow of funds.

The forecast of funds is the focal point for advance planning. Budgeting should concern itself with the beginning cash balance, the inflow and outflow of funds and the ending balance for each period. There are 12 sources of cash explained and appraised:

1. Surplus cash.
2. Throw-off from depreciation and depletion.
3. Receipts from employe stock purchase or stock option plans.
4. Earnings retained after payment of dividends.
5. Issuance of new common stock.
6. Convertible preferred stock issues.
7. Convertible debenture issues.
8. Long-term loans from insurance companies.
9. Long-term loans from commercial banks.
10. Leases and leasebacks.
11. Supply contracts with 50%-owned nonconsolidated subsidiaries.
12. Increase in liabilities.

Since cash is an item of greatest importance to all business establishments, this thorough discussion of its planning should be carefully studied by all members of management.

CONCLUSION. This book can best be summarized by paraphrasing the author's last sentence . . . "the greatest help to the reader will come from a patient study of the exhibits (and simplified explanations) which will . . . clarify the recommended techniques."

This book, "Financial Analysis for Management," provides a common ground of understanding between the operating executive who must use financial statements and those members of his staff who have the responsibility for preparing and interpreting them.

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RECORDS RETENTION: A Practical Guide*

By William E. Mitchell

The main objective, as stated by the author, is "to acquaint the reader with practical measures that can be taken to dispose of old business records." For instance, in complying with government regulations, the author advises compliance with the intent of the law rather than reading into it more than it says or implies. On legal requirements, Mr. Mitchell says sharp analysis "indicates considerable duplication in requirements. When you comply with a few basic requirements, you automatically comply with a score of others."

Other sections deal with establishing the program, ground rules to keep in mind, the recommended retention schedule, and preparing the schedule. Also included are schedules for payroll records, state tax records, Interstate Commerce Commission, and states' statutes of limitations.

* *Published by Ellsworth Publishing Co., 314 Newcastle Road, Syracuse 4, N. Y. $5.00.*

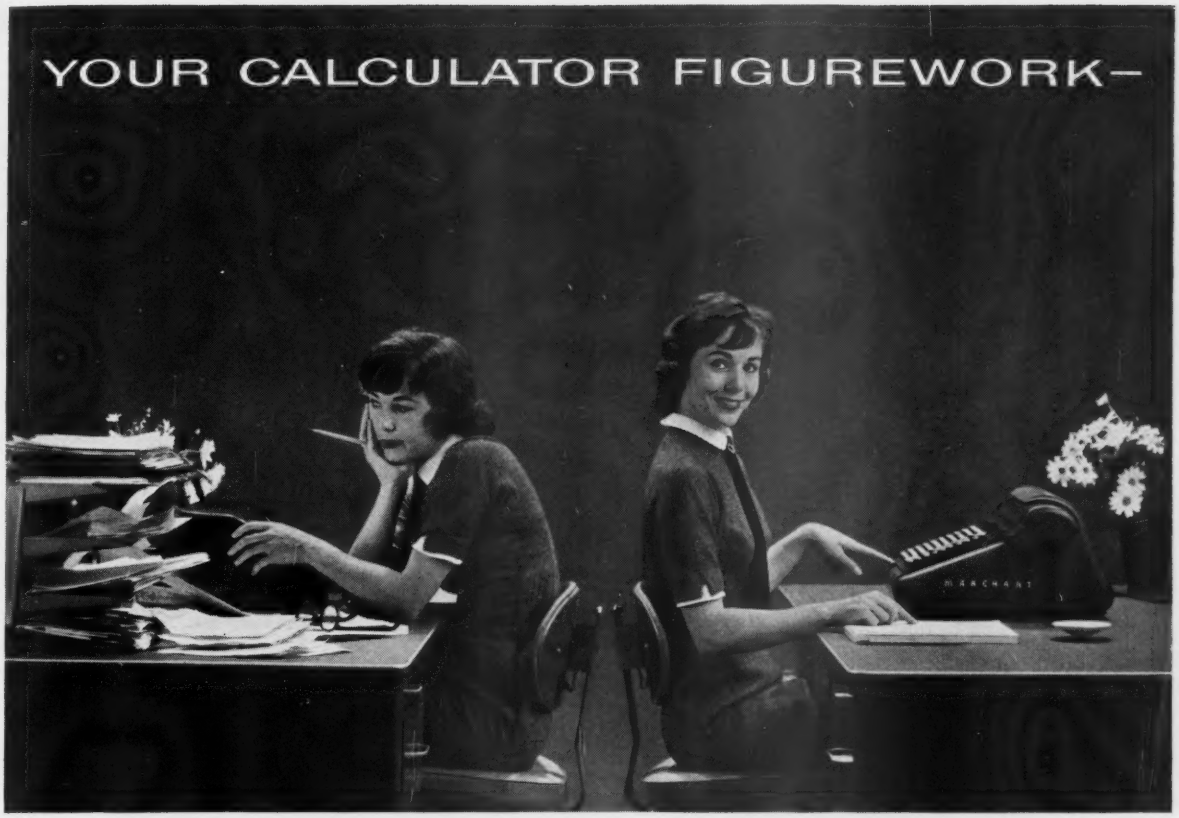
INVESTMENT MANAGEMENT*

By Harry Sauvain

In this book, the second edition, the author deals with the problems of investing for individuals and for investing institutions, and defines his approach as an attempt "to develop a coherent theory of the problem of grading and valuing securities."

In addition to corporate and governmental securities, the author includes chapters on investment risks, investment policy, six new chapters on security analysis, and, in the last four chapters, deals with the main types of institutional investors.

* *Published by Prentice-Hall, Inc., Englewood Cliffs, N. J. $9.25.*



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Information-Transfer System to Assist Mgrs. in Planning and Controlling

(Continued from page 454)

and his supervisor, so that they can reach agreements on plans and performance. Periodic face-to-face conversations are essential to reaching such agreements.

If these conversations do not take place, the information-transfer system simply is not being used; and its value suffers accordingly. Furthermore, these face-to-face conversations must take place at all levels in the organization structure—right up to the department manager level.

WHAT'S DIFFERENT?

How does this system differ from what was formerly in effect?

In our case:

1. The man and his supervisor can look at numbers which more precisely describe the results the man is to achieve in his job and resources needed. (These numbers include both dollars and physical units.) This is in contrast to using (a) accounting numbers oriented not to an individual's performance, but rather to the actions of geographical or functional groups, or (b) accounting numbers which are not directly controllable.

2. In the course of scheduled discussions, the supervisor is able more clearly to communicate to the subordinate the desired level of results. At the same time, the latter has the chance to indicate, also with greater clarity, the results which can reasonably be expected under anticipated conditions. This is in contrast to situations where (a) viewpoints and knowledge held at field levels simply do not get into the stream of information moving upward through the organization, or where (b) top-management attitudes and decisions become diluted or filtered in the course of transmission downward through the several levels of supervision.

3. Specific objectives to be reached in the future can be agreed upon as being attainable by the man and his supervisor. This is in contrast to having the supervisor independently set a quota—and this often arbitrarily, at least as far as the man who has to "make the quota" is concerned.

4. Performance can be evaluated in terms of whether or not agreed-upon results were achieved with agreed-upon resources. This is in contrast often to an absence of any satisfactory method for telling the man "how he is doing."

5. Managers at different levels are looking at the phases which they can do something about. The man closest to the point of action has the best opportunity to deal with the immediate future; the man at higher levels has the vantage point and the responsibility to affect decisions further in the future. This is in contrast to having managers at higher levels attempt to make sales decisions affecting the immediate future of a local operation and neglecting consideration of the problems which lie further down the road.

6. The man and his boss periodically compare attainment of goals against plans and agree on what revisions have to be made in uniform future periods, giving effect to changing circumstances. This is in contrast to looking ahead once a year and measuring performance against a budget which becomes increasingly unrealistic as the months go by.

BENEFITS

Based on our experience to date in the pilot test, we believe that this information-transfer system will bring about these benefits:

1. The executive will be placed in a better position to evaluate the essentiality of an activity, as well as the likely outcome of changing the relationship of resources and results. *(What will you get from adding one more unit of effort; what will you give up by reducing one unit of effort?, etc.)*

2. Managers at lower levels, having knowledge of both results and resources in a given situation, will be able to make decisions in terms of the total activity—not just one phase of it.

3. Managers will be able to give better supervision in telling subordinates more precisely what is expected, in evaluating performance, and in taking corrective action.

To sum up, we believe that we have here a tool which (a) helps managers think more precisely about their own responsibilities and the courses of action which can be undertaken to fulfill these responsibilities, as well as the responsibilities and courses of action of people reporting to them, and which (b) gives managers, on a regular basis, the more specific information needed to seek out and understand significant relationships.

Such a tool should, in time, help managers at all levels make better decisions—and thereby develop further a skill required in their climb up the management ladder.

HOW DO YOU GO ABOUT THIS?

Putting this type of system into effect calls for taking four major steps:

1. Create results-resources forms for selected positions. This means: (a) Interviewing people to identify with them what are the results and resources in their particular jobs; (b) developing a tentative form; and (c) reviewing this tentative form with each man's supervisor. The entire process varies with the nature of the position; an average time requirement would be six man-days for each position (four days on the part of a task force made up of company people and outside consultants, one and one-half days on the part of the man for whom the form is

(Continued on page 478)

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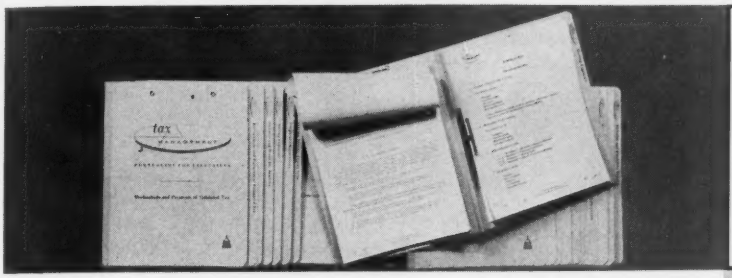

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- ☐ Corporate Acquisitions

being made, and a half day on the part of the supervisor). Obviously, where position titles and duties are the same for many people (as, for example, sales representatives), there is no need to spend time with each person.

Defining results and resources categories represents the key point in the entire effort. These categories must be specifically tailored to the job and the supervisor must agree, if the benefits of the system are to be realized. Thus, it is essential that the over-all effort of preparing these statements be shared by the study team and by the managers whose activities are covered by the system.

2. The next step is to try out the system in a segment of the organization. We started with a district. It soon became apparent that the decisions made in the district and the actions taken there affected people in other parts of the organization. At the same time, it is evident that actions of people in other districts, in the division office and in the home office also had a bearing on what was being done in the "guinea pig" district. Furthermore, the district was found not to include a broad enough sample of different jobs. Thus, it was necessary to carry the test beyond the boundaries of a particular district—in our case to a division.

3. Concurrently, steps should be taken to establish the information-transfer system needed to produce desired reports. This calls for:

a. Determining sources of input information by scanning each report format, item by item.
b. Developing input mechanism, including frequency of reporting, permissible time lags and establishment of input and processing controls.
c. Writing computer programs.
d. Designing output forms.
e. Identifying deletions from the present reporting system.

The computer programming effort, in our case, is done largely by people in the Data Processing Unit of the Comptrollers Department. The remaining activities are conducted by the task force.

4. The last step is a comprehensive explanation of the entire procedure to all people affected.

INFLATION—Facts · Facets · Future

The Economic Conditions under which Business Now Operates.
Dr. Addison T. Cutler, Special Economist, and Fred O. Kiel, Senior Economist, Federal Reserve Bank of Cleveland.

Accounting in an Inflationary Era.
Leonard Spacek, Arthur Andersen & Co. and Perry Mason, American Institute of Certified Public Accountants.
Plus a panel of members of Controllers Institute.

Counteracting Inflation in Costs, Labor and Tax Planning Areas.
Moderator, Charles Stewart, Machinery & Allied Products Institute.

Outlook for Labor Cost.
Leland Hazard, Carnegie Institute of Technology.

Cost Reduction.
C. C. Caditz, Metal Products Company.

How Foreign Operations Are Conducted and Why.
Moderator, Harvey Williams, president, Philco International.

Dealing with Peoples and Authority Abroad.
Stephen Rundt, Rundt Associates.

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Complete information concerning the Transacter System may be obtained from Stromberg Time Corporation at Thomaston, Connecticut, or from any of its Sales and Service Offices in the U. S. A.

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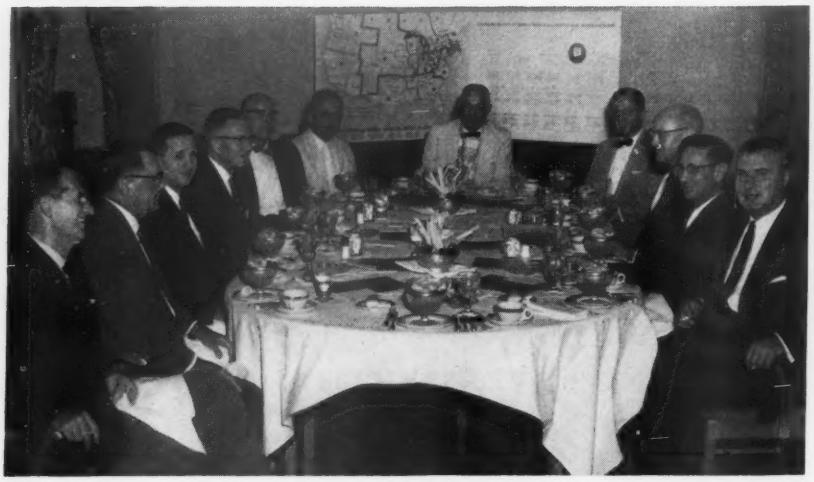
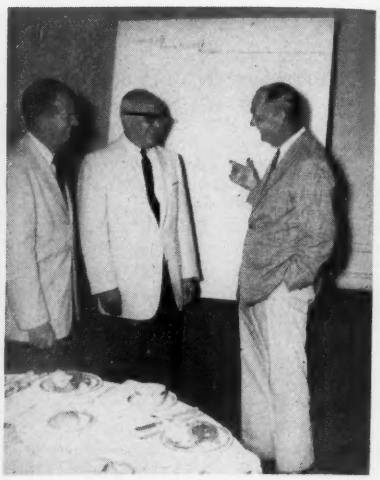




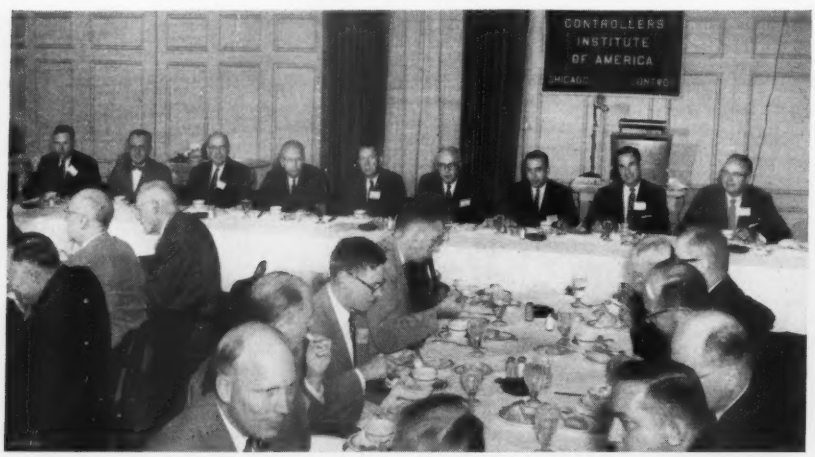
Rye, N. Y. (ABOVE LEFT)

On the day prior to the recent meeting of the national Board of Directors of Controllers Institute of America, held at the Westchester Country Club, President Roger A. Yoder, vice president-finance, Detroit Steel Corporation, met with the Area vice presidents to coordinate their plans for the 1959-60 fiscal year.

Around the table *(left to right)* are J. McCall Hughes, national chairman of the Board of CIA; John C. Shea, vice president of the *Southern Area;* James L. Peirce, immediate past Board chairman; D. E. Browne, a past national president who represented the *Western Area* at the meeting; Edward H. Eaton, vice president, *North Central Area;* Mr. Yoder; Paul Haase, managing director of Controllers Institute; Ben Makela, associate secretary, CIA; Donald P. Jones, vice president, *Eastern Area;* Donald A. Robertson, vice president, *Midwestern Area;* and Eric L. Hamilton, vice president, *Northeastern Area.* In the background is a blow-up of the new Area map and organization chart.

(ABOVE RIGHT)

Institute officials discuss reorganization plans. Standing before a blow-up of the new letterhead to be used by Controllers Institute Research Foundation are: *(Left to right)* J. McCall Hughes, Roger A. Yoder, and Robert L. Dickson, 1959-60 president of the Foundation.



Chicago, Ill. (BELOW LEFT)

Members of the Chicago Control of Controllers Institute opened their season of dinner meetings on September 17 with an address by Lem Hunter, vice president of Inland Steel Company, on the steel strike. Honor guest at the meeting was Roger A. Yoder, president of the Institute. Mr. Hunter is seated fourth from the left at the head table; Mr. Yoder is fourth from the right. Seated center is Raymond H. Giesecke, president of the Control and treasurer, McGraw-Edison Company. Others at the head table include *(left to right)* Robert A. Bowen, assistant controller, Quaker Oats Company; Paul Haase, managing director, CIA; O. R. Egan, comptroller, Inland Steel Company; Leonard S. Zieve, treasurer-controller, the Toni Company Division of the Gillette Company; Rexford E. Bruno, comptroller, United Airlines, Inc.; and Charles F. Axelson, controller, United States Gypsum Company.

(BELOW RIGHT)

Institute President Yoder *(center)* is greeted by Charles Z. Meyer *(right),* 1951-52 president. Past President James L. Peirce, 1957-58, is looking on *(left).*

Civil Servants' Productivity Up

The productivity of federal government employes improved during the last 12 years at an annual average rate of 1½ per cent, according to an analysis by Henry D. Lytton, an economic consultant in Washington. His analysis is based on output by the person rather than by the hour. It uses a combination of methods to calculate the work put into a job and the product that comes out—the relationship being productivity.

Mr. Lytton used recent estimates by the National Bureau of Economic Research to compare government with private industry. The Bureau's estimate, as reported by Mr. Lytton, found productivity rose in the private domestic economy at an average of 3.1 per cent a year for the 12 years through 1958—the years covered by the Lytton study.

His analysis was based on computations already prepared by five government agencies that employed roughly two thirds of the civilian federal workers outside of Congress, the judiciary and the Defense Department.

The five agencies showed average annual improvement ranging from 1¼ per cent in the Post Office to 8 per cent in the Commodity Stabilization Service. The over-all figure showed a decline for 1953 and 1958, but an advance of 17 per cent for the full 12-year period.

Railroad Data Processing

The settlement of interline freight accounts between three major railroads has been effected through a simple exchange of magnetic tapes. Representatives of the Illinois Central Railroad (Chicago), Southern Railway (Washington, D. C.) and Union Pacific Railroad (Omaha) exchange their monthly checks, supported by a roll of magnetic tape in lieu of the large stacks of interline abstract sheets hitherto exchanged between these railroads each month. The new procedure has become possible because of the compatibility of the data-processing installations of the three railroads. Settlement of freight accounts represents both the largest exchange of information and also the largest amount of paper exchange between railroads. In the new procedure, the information on the tapes will be fed into large-scaled data-processing machines used by the receiving railroad.

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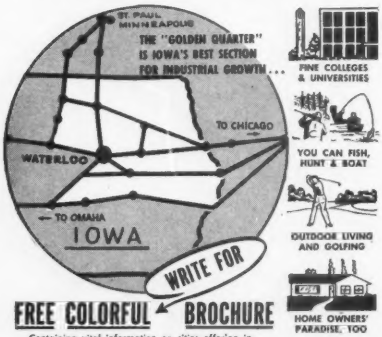

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Short-Term Investment of Surplus Cash

(Continued from page 457)

Commercial paper

Another major outlet for surplus corporate funds—and an increasingly popular outlet—is commercial paper. Commercial paper refers to the short-term notes which are issued by finance and industrial companies to cover at least a portion of their short-term borrowing requirements. The paper of the prime finance companies usually sells at a slightly higher yield than U. S. Treasury bills of the same approximate maturity, and the rates of the large industrial issuers and of secondary finance companies and industrial issuers scale upwards above the prime finance company level depending upon the investment standing accorded to the issuer. The term "prime" is applied rather loosely by many individuals in the commercial paper field to any well-known corporate name. In the strict sense and as used here, "prime" refers only to the largest finance companies who set the prime commercial paper rate.

Finance company paper, in addition to providing a slightly higher yield than U. S. Treasury bills and most other government securities, can usually be purchased with any specified maturity date from 30 days to nine months, thereby providing income to the investor up to the exact date that he may require the funds. Several finance companies also usually deal in maturities of five to 29 days. The paper of industrial companies, on the other hand, is generally offered with maturity dates that are suited to the financing requirements of the issuer. Finance company paper may be purchased directly from the issuer, or through banks or one of several brokers specializing in commercial paper. Industrial company paper is generally purchased through one of these same brokers.

An area of controversy exists with respect to investment in the commercial paper of so-called second-line companies. Many investment advisors feel that expansion of commercial paper purchases beyond the prime finance companies, plus several other major finance companies, constitutes an unwarranted degree of risk-taking by the investor for the sake of the incremental yield.

An alternate viewpoint is expressed by numerous investors who feel that the additional ½ of 1% per annum which can frequently be obtained in the paper of medium-sized finance companies, for example, is a desirable objective. Although the smaller company may compare favorably on a statistical basis with the prime company—in terms of ratio of capital funds to total liabilities, for example, and in terms of other ratios—the corporate investor is forced to assume the mantle of investment analyst, if he embarks on a program of purchasing secondary paper. He is compelled to place a dollar limitation on investments in order to maintain diversification and is obligated to compute balance sheet ratios, to inquire into bank lines of credit, and to otherwise satisfy himself as to the investment standing of the issues of the paper.

In actual practice, it is likely that a well-planned policy of Treasury bill investment, supplemented by investment in higher-yielding conventional securities and in prime commercial paper, will produce a satisfactory income return, with less room for criticism or controversy than would exist if substantial amounts of second-line commercial paper are included in the portfolio.

The commercial paper of the major Canadian finance companies, as well as Canadian government securities, can often be purchased at significantly higher yields than is offered by their United States counterparts. Unless protection against the hazards of currency exchange fluctuation is obtained, the U. S. investor is in a speculative position, however. When this hazard can be hedged by selling Canadian dollars forward, the Canadian holdings may afford a liberal and safe yield. The U. S. investor should remember that the 15% Canadian withholding tax acts, in effect, to postpone collection of a portion of the interest earned. United Kingdom (British) Treasury bills have also been available from time to time in the past on a satisfactory yield basis, when the exchange fluctuation risk could be hedged at low cost.

Time deposits

During many months of 1958, when interest rates on the various government securities declined to very low levels along with commercial paper yields, time deposits placed in commercial banks provided a comparatively higher return on investment. Many banks in the eastern section of the country were (and are) not receptive to interest-bearing time deposits, except under unusual circumstances. Southern and western banks, however, with their proportionately higher savings deposits and with the consequent opportunity to loan money on mortgages, frequently welcome time deposits. The corporation placing funds in a time deposit should be certain that the depository bank recognizes the arrangement as a mutually profitable transaction, in order to avoid the illusion that the bank has extended a one-sided accommodation.

The investor in time deposits should remember that his funds are frequently committed under a firm or gentlemen's agreement not to request withdrawal prior to maturity, thereby virtually eliminating the possibility of riding the curve or of performing profitable switches which oc-

casionally can be developed in marketable securities.

Bankers' acceptances

Bankers' acceptances are purchased by many corporations as an investment medium. These acceptances represent notes which have been issued by borrowers to finance the export, import and domestic shipment or storage of goods, with the notes "accepted" by the lending bank, thereby placing the credit of the bank behind that of the borrower. The notes are then salable in the open market as short-term investments.

Other investment possibilities

The preceding paragraphs have described some of the more conventional types of investment opportunities for corporations. There are other, less commonplace, media for investment which are generally disregarded by the large corporation, because the amounts of money which can be placed therein are usually limited. The investor who is dealing with hundreds of thousands of dollars (rather than millions), who has the time and flair required, and who is "hungry" for the extra income which is sometimes available may wish to look into the possibilities of savings and loan account deposits, secondary market purchases of negotiable certificates of time deposit, investment in the called bonds or stocks of other companies, etc.

At a couple of points in this article, I have referred to "banking relationships." It should be remembered that the investing corporation of today may very well be the borrowing corporation of tomorrow. And the executive who has strained his banking relationships by excessively reducing his bank balances to realize extra interest income from today's cash funds may in fact have done his corporation a disservice, if it results in a frosty reception at the loan window tomorrow.

INCREASING INVESTMENT "KNOW-HOW"

An encyclopedic review of the short-term investment of surplus cash would require considerably more text than is devoted to the subject on these pages. The interested reader may expand his knowledge of the subject by reference to literature which can be provided by major banks, by government security dealers, and by commercial paper brokers. Several theses submitted by candidates for post-graduate degrees constitute the most valuable store of helpful information, but unfortunately have had only limited circulation. Additionally, "know-how" is obtainable through personal contact with investment personnel of other corporations, banks, and security dealers. As in all areas of controllership, however, there is probably no more effective means of learning than through doing.

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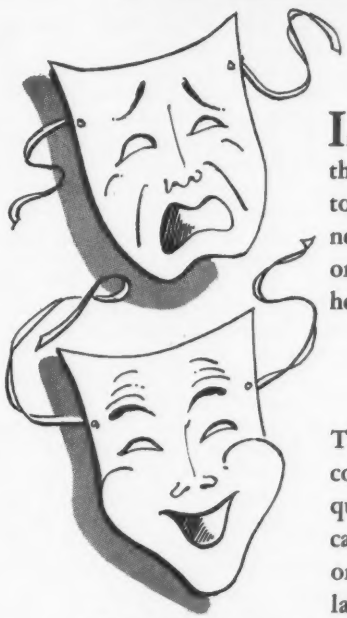

In most organizations (small or large), the cost is in general overhead. It pays to find out *true* cost. Today's average net profit is so low it may take $40.00 or more in sales to pay for each overhead dollar.

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Correspondence *(Continued from page 448)*

COMMENTS ON "RETURN ON WHAT INVESTMENT?"

the streams of cash flows is most desirable.[6]

The decision involving the choice of optimum-sized plant is another mutually exclusive investment decision. Here the investments all perform the same function, but have different capacities and different costs. There is no reason why the cash flows resulting from the different possible facilities cannot be analyzed and the best alternative chosen. Thus one alternative may be to build only enough capacity for present needs. Another alternative may be to build twice enough capacity as is needed now on the assumption that demand will gradually grow over the next ten years. The cash flows resulting from both these assumptions can be estimated, and a correct decision made. An incorrect decision will be made if the cash flows resulting from today's demand is compared with outlays required for supplying enough capacity for the next ten years.

If the excess capacity is purchased, *should it affect the measure of performance of today's operations?* A "yes" answer is incorrect. In a sense we are buying the cash proceeds of the next ten years and paying a certain amount for the proceeds of each year. Carrying this assumption to a logical conclusion will result in a measure of performance undistorted by the purchase of excess capacity.[7] Stated more simply, the portion of the investment not intended to be used in the accounting period should not affect the measure of performance of that period.

As a by-product of the question considered above, Weaver explores the question of whether the single investment which forces the purchase of a new boiler should bear the entire cost or a pro rata share of the cost of the boiler based on the needs of the new investment. In making the investment decision, the new boiler should bear the burden of the total cash flows which will result because a new boiler is being purchased, but the analysis of cash flows should include the cash resulting from any new products which may be added because of the increased capacity.

Let us assume that the new boiler is purchased, and there is excess capacity. If a new product comes along which can recover variable cost and a little over, but not its share of the cost of the boiler, *should it be added?* The answer is "yes," since on an incremental basis the company will be better off by the amount of the excess of revenues over the variable cost.

Weaver then asks the question of how to incorporate the fact that the next purchase of a boiler is advanced since the new product has been added. The implication is that we will continue to add boilers and then add on an incremental basis products whose revenues do not cover boiler cost, thus we are making incorrect decisions.

Actually we must not forget that when the boiler reaches capacity, and a new product is being considered, that one of the alternatives will be to drop one or more old products to make room for the new product. In this situation an old product which is not recovering its share of the new boiler will be re-appraised and its abandonment considered.

Thus it may be desirable to add a product when there is excess capacity and drop it when the capacity is needed. In considering the addition of a product which does not recover its full costs of production, we should take into consideration the ease with which the product may be dropped if the situation of excess capacity becomes a situation of not enough capacity.

How does the prospect of inflation affect the decision whether or not to build excess capacity? If we expect inflation to outrun technological improvement, our preference would generally be to build excess capacity now before prices go up. *But how much excess capacity?* This question can be answered by comparing the cash flows which result assuming immediate purchase and delayed purchases. While this comparison becomes complex using return on investment, or rate of return (or profitability index), it is easy to compute using the present-value method.

CONCLUSIONS

In making decisions or measuring performance there are problems of deciding on the relevance of the cost of facilities presently owned (thus fixed costs) and the cost of facilities being considered which may have excess capacity. This author considers the present facilities relevant in making investment decisions if there is an opportunity cost connected with using the facilities. To make the investment decision involving additional plant, which will make use of present facilities, the explicit computation of the opportunity cost may be by-passed by the use of the present-value method of discounting cash flows, but the principle of opportunity cost is built into the procedure since all possible uses of the facilities are considered.

When the purchase of excess capacity is being considered, the justification for the excess capacity must be based on the prospect of future use. The amount of excess capacity which is desirable may be computed making use of the present-value method of discounting cash flows. After purchase, the excess capacity should not affect the measure of performance of the initial accounting periods, if at the time of purchase it was expected that there would be excess capacity.

Though differing in detail, this author agrees with Weaver on the use of an incremental analysis, which takes into consideration the timing of the cash flows by discounting the flows back to the present, to solve the type of problems being considered in this paper.

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[6] Weaver, *op. cit.*, p. 368. Weaver suggests the use of rate of return, but the author would prefer the present-value method. It is possible to reconcile the two procedures in the type of situation being considered.

[7] See Bierman, *op. cit.*, pp. 370-371.

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Ronello B. Lewis, as Vice President and Controller of Olin Mathieson Chemical Corporation, from 1953 to 1957, headed an accounting and control organization that performed services for management in more than 20 operating divisions of a rapidly growing industrial corporation.
From 1949 to 1953 Mr. Lewis was controller of the Radio Corporation of America, and for seventeen years prior to that he was with two merchandising companies.
Mr. Lewis is a member of the Controllers Institute of America and a Trustee of its research arm, The Controllership Foundation. In August, 1957 he became a partner in E. F. Hutton & Company, members, The New York Stock Exchange.

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Crucial Choices Determine Success or Failure of EDP

Arriving at a good decision as to the size and scope of an electronics program and carrying it out are two distinctly different matters, according to *Business Experience with Electronic Computers,* a forthcoming research report of Controllers Institute Research Foundation. A major deficiency in either area will rarely permit over-all success and will most likely lead to serious difficulty, the authors report in citing fundamental propositions for a successful business electronics installation.

Of the thousands of individual judgments and choices which must be made in the course of reaching a basic decision and implementing a program, there are some which will be of critical importance, drastically improving or reducing the chance of success. It is around those crucial choices, which bear most strongly on success or failure, that the report revolves.

A synthesis of the experience of 17 companies shows that it is well for a company considering or embarking on an EDP program to recognize the following points:

1. The objectives, or at least their relative importance, are often not clear to an EDP group and they, therefore, need direction and guidance in this respect.
2. Many of these objectives are not easy to evaluate in monetary terms, yet some value must be placed on them if a proper economic appraisal is to be made.
3. In most companies, some objectives will conflict with others. For example, better customer service may be achieved only at added cost; greater accuracy and control only at the expense of speed.
4. Since it is often not possible for management to state its objectives clearly without some understanding of the costs, risks and gains involved, it is usually too much to expect that a single meeting will suffice to get these objectives clearly established.
5. The process of consciously establishing objectives will often overcome the bias of the group originating the interest in electronics.
6. The process of establishing or helping to establish goals and objectives helps to educate management in EDP and to provide a sound basis for both the support and the critical evaluation which they should supply.

More Automation on Wall Street

$3 million worth of electronic data-processing equipment has been moved into the New York offices of Bache and Company. One of the world's largest stock brokerage houses, Bache is leasing the IBM 705 Model III computer to handle its growing volume of stock transactions.

The computer will enable it to complete the paperwork on its average of 6,500 daily trades in 12 hours—half the time needed previously. In addition to processing purchases and sales, the system will maintain stock records, perform margin and bookkeeping operations and prepare monthly customer statements.

A fully automatic brokerage private wire system, a 27,000-mile, two-way network leased from Western Union, links Bache offices throughout the country. One important feature of the system is a device in its New York high-speed message center that automatically segregates and distributes messages, arriving from all points, to 25 posts in the Bache order room. Provision is also made for priority traffic.

Corporate Aid to Education

International Business Machines Corporation announced it will match contributions made by its employes up to $1,000 for each institution per calendar year. The IBM Matching Grants to Education Program includes accredited colleges, universities, and technical and business schools above the high school level.

Christmas Currency

Cash presents to unnamed recipients were disallowed by the Tax Court as a tax deduction when the firm which gave the currency at Christmas time to employes of customers and suppliers refused to divulge the recipients' identities. The company had claimed the grants, which in one year totaled as much as $27,500, as an advertising expense.

Plow Back or Pay Out?

The New York Stock Exchange magazine doesn't answer this question, but it did compile a list of 20 high dividend payers and 20 low payers figured as a percentage of profits. A comparison of the two lists shows pay-outs in 1958 among the 40 companies ranged from 10.3 per cent of the net available for dividends to 115.4 per cent. In each of the past five years every one of the 20 issues in the large pay-outs group has made cash dividend payments amounting to 67 per cent or more from the net available for that purpose. In each of the past five years none of the 20 issues in the small pay-outs group has made cash dividend payments amounting to as much as 49 per cent of the net available.

Financial Assets of Individuals Higher in 1958

A sharp increase in the market value of preferred and common stocks was the major factor in boosting the level of individuals' financial assets by more than $130 billion between the end of 1957 and the end of 1958, according to the National Industrial Conference Board's "Road Maps of Industry" series.

At the close of 1958, individuals in the United States owned nearly $900 billion worth of financial assets. Holdings of corporate stocks and bonds amounted to $377 billion, with the remaining $513 billion consisting of cash, bank deposits, savings and loan shares, insurance and government securities.

Trend to Tape Continues

Sales of magnetic tape last year topped $21 million—almost double 1957's $11.7 million and more than three times the $6.2 million of 1953. Businessmen find the many assets of magnetic tape add up to substantial cost reductions. One is the tape's ability to retain masses of information in a small space permanently and to permit it to be erased and replaced if need be. Tapes can be cleaned and reused again and again, and the information can be reproduced at high speed immediately after recording since there's no developing or processing involved. In addition to feeding computers and storing records, tape is used in running machine tools, rebroadcasting TV shows, recording music, and filing Social Security reports.

U.S. Productivity Still Rising

Contrary to a position taken by some labor, business and financial leaders, the productivity of the United States economy has been increasing at an even greater rate in recent years than in the period before

World War II, according to a forthcoming study by the National Bureau of Economic Research. The national product per capita in the United States, measured in real, not inflated terms, is higher than in any other country, and because man-hours of work per capita are lower in this country than any other, national product for each man-hour is higher still.

Over the last eight or nine decades, national product per capital has been rising in the United States at a rate approaching 20 per cent each decade. For the private economy, national product for each man-hour of work rose more rapidly—about 25 per cent in each decade. According to the report, an important fact is that the long-term pace of advance in man-hour output has been speeded.

'59 Plant and Equipment Programs Higher Than Anticipated

Business expenditures on new plant and equipment are expected to amount to $32.5 billion in 1959, compared with the 1958 investment of $30.5 billion, according to the latest joint survey of the Securities and Exchange Commission and the Department of Commerce. The total is seven per cent above capital outlays for 1958 and 12 per cent below the 1957 aggregate. Except for public utilities and nondurable goods manufacturers, all major industry groups have raised their 1959 programs from those anticipated earlier this year.

Big Spender

On the first day of the 1959-60 fiscal year, the Federal Government spent exactly $225,523,157.27, more than $2,600 for each second of the 24 hours. Although this was more than the entire annual budget for any year up to the time of the Civil War, it was just an average day's spending under a $77 billion budget.

Student Edition of Annual Report

Scott Paper Company has published a special Student Edition of its regular 1958 annual report. The Student Edition consists of the regular report with specially annotated pages, keyed to the text and figures, containing brief explanations of corporate operations and accounting terminology. Special attention is devoted to the consolidated financial statements, the shareholders' investment and other significant items.

Employe Presents

IRS has ruled that the value of a turkey, ham, or other nominal property gifts bought by the boss and handed each employe at Christmas or other holidays is not taxable income to the recipients. In addition, the cost of such presents is deductible by the employer as a business expense since they are intended to "promote good relations" with employes.

For what it's worth...

How fixed are "fixed" assets?

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The mere mention of the term "current assets" brings to mind such items as cash, inventories, and accounts receivable. These assets are considered short-lived, mobile and changeable; yet, during their comparatively short life, an accurate account is kept of each item until it clears through the records.

Trend to relocation

Can "fixed" assets—the plant itself, buildings and equipment—go through a metamorphosis and emerge as assets necessitating similar financial control? By time-honored precedents, manufacturing facilities have, until recently at least, been designated as "fixed" with all the permanency, long life and immobility that the word implies.

In recent years many plants have relocated to take advantage of more favorable sources of raw materials, better transportation, available labor and nearness of markets. Existing equipment is also subject to accelerated obsolescence, abandonment, changes in use, reconstruction or replacement. Are such assets "fixed" in view of the existing trends to improvement or change?

Properties "on the move"

With the possible exception of land, "fixed" assets are not fixed in the sense that they are permanent. Some future event or decision of management may cause the continued use of the "fixed" assets to be terminated more quickly than anticipated because of sale, abandonment or obsolescence.

In this era when plant properties —often the largest item on the balance sheet—can be said to be on the move, it is desirable to provide for their control and accounting as effectively as for current assets. This is possible through basic unit property records kept constantly up to date to reflect changes that have actually taken place or that may be contemplated by management.

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NEW CONNECTIONS . . .

James A. Marohn was elected executive vice president of the Leece-Neville Company, Cleveland, Ohio. . . . **T. P. Boyle** has joined Canada Iron Foundries, Limited, Montreal, Quebec, Canada, as controller. . . . **Allen M. Harrelson** was elected treasurer and chief financial officer of Crane Co., Chicago, Ill. . . . **Wayne Irwin** has been elected vice president-finance, Accounting, Taxation and Valuation of the Association of American Railroads, Washington, D. C. . . . **M. H. Koenig** has joined Mosler Safe Company, Hamilton, Ohio, as comptroller.

COMPANY CHANGES . . .

United States Steel Corporation recently announced various changes in its executives' responsibilities: **C. Burton Vernooy** was appointed administrative vice president-accounting at Pittsburgh, Pa. . . . **Wilbert A. Walker** was named administrative vice president, in addition to his present duties as comptroller, at New York. . . . **John Pugsley** was elected executive vice president-accounting at Pittsburgh.

Arthur M. Wittman, formerly controller, Pacific Division was transferred to Dayton, Ohio, to take over new duties as assistant treasurer of the Standard Register Company. **Leonard J. Ertel,** treasurer, continues in that office. . . . **R. Burt Gookin** was elected vice president-finance, as well as a director and member of the Executive Committee, of H. J. Heinz Company, Pittsburgh, Pa., succeeding **Frank B. Cliffe** who retired on September 30. Mr. Gookin has long been active in the affairs of Controllers Institute having served as chairman of the national Committee on Management Planning and Control for two years. He is currently general chairman of the 1959 Annual National Conference of Controllers Institute to be held in Pittsburgh on October 25-28 at the Penn-Sheraton Hotel.

ADDITIONAL DUTIES . . .

H. E. White has become vice president and controller of Rochester Telephone Corporation, Rochester, N. Y. . . . **A. T. Miller** is now comptroller and treasurer of Barber's Super Market Stores, Albuquerque, N. M. . . . **Robert W. Halliday** is vice president and comptroller of Boise Cascade Corp., Boise, Idaho.

PROMOTIONS . . .

Keith P. Hudson has been appointed vice president of Di Giorgio Fruit Corporation, San Francisco, Calif. . . . McCord Corporation, Detroit, Mich., recently announced that **Lester M. Elliott** had been named first vice president. He has been an active member of Controllers Institute for many years and served as president of the Detroit Control, 1952-53. . . . **Mario R. Funari** has assumed the duties of corporate controller of the Weatherhead Company, Cleveland, Ohio.

Technical Products Division of Waste King Corporation, Los Angeles, Calif., has announced the appointment of **Keath L. Bills** as controller. . . . **Robert E. Kenoyer** has been elected controller of Sylvania Electric Products Inc., New York. . . . Crown Zellerbach Corporation, San Francisco, Calif., recently announced the election of **William L. Meyer** as controller.

Lionel M. Goldberg recently became vice president, general manager and a director of National Kraft Container Corporation, Jersey City, N. J. . . . **Raymond F. Bonenfant** has been appointed controller of NRC Equipment Corporation, Newton Highlands, Mass.

MR. VERNOOY

MR. WALKER

MR. PUGSLEY

SUBSCRIPTIONS TO

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MR. TODT

HONORS TO . . .

New officers who were elected for terms beginning January 1, 1960 at the annual meeting of the American Accounting Association held at the University of Colorado, Boulder, Colo., in August. They are: *President,* **A. B. Carson,** University of California, Los Angeles, Calif.; *vice presidents,* **Charles E. Johnson,** University of Oregon; **Walter G. Kell,** Syracuse University; **Glenn A. Welsch,** University of Texas; and **Hans Todt,** comptroller, Bristol Laboratories Inc., Syracuse, N. Y. **Carson Cox,** Ohio State University, will serve as *secretary-treasurer.* Mr. Todt is the only officer elected from the field of industry. He has been active in Controllers Institute as chairman of its national Committee on Education.

D. B. Paquin of Lybrand, Ross Bros. & Montgomery, Chicago, Ill., was elected 1959-60 president of the National Machine Accountants Association at the organization's 1959 National Conference in St. Louis. . . . **Dr. Lillian Gilbreth** of New York City was named to receive the 1959 International Systems Award to be given at the 12th annual International Systems meeting of Systems & Procedures Association of America to be held October 12-14 in Toronto, Ontario, Canada.

The award to Dr. Gilbreth is made *"in recognition of a lifetime of leadership and accomplishment in fields which contribute so fundamentally to the sciences on which business systems work is based."*

George T. Clarke, associate professor of marketing, New York University, New York, was named director of the Advertising Federation of America's Bureau of Education and Research. He will continue in his present capacity at NYU. . . . **Edward G. Koch** has been appointed visiting professor of Business Administration in the Graduate School of Business Administration of the University of California at Los Angeles. . . . **C. R. Niswonger** was named visiting professor of accounting at Arizona State University, Temple, Arizona.

WRITERS . . .

Harold H. Scaff, vice president, Ebasco Services Incorporated, New York, is author of an article in the August 1959 issue of the *Journal of Machine Accounting* entitled "Significant Developments in Cost Control."

SPEAKERS . . .

One of the guest speakers at the American Management Association's seminar on "Short- and Long-Range Total Planning" held September 14-18 at the La Salle Hotel, Chicago, Ill., was **John N. Latter,** controller, Bell & Howell Co., Chicago. . . . At the NAA subject conference held on September 24-26 at the Edgewater Beach Hotel, Chicago, Ill., **Guy F. Campbell,** executive vice president and general manager, Junior Toy Corporation, Hammond, Ind., acted as chairman of the afternoon session on the 24th when the subject discussed by **Kenneth R. Rickey,** vice president and treasurer of Lenkurt Electric Company, Inc., San Carlos, Calif., was "A Company Executive Looks at Direct Costing."

Cecil L. Clark, vice president and treasurer, Sangamo Electric Company, Springfield, Ill., chaired the session the next morning when the speakers and subjects were: **J. Curran Freeman,** controller, Dresser Industries, Inc., Dallas, Texas, speaking on "How We Use Direct Costing for Profit Planning" and **James McKenna,** controller, Hoffmann-LaRoche Inc., Nutley, N. J., discussing "Contributions of Direct Costing to Development of Costs for Management Decisions."

The following will participate in the various programs of seminars and conferences of the American Management Association this fall: Workshop Seminars scheduled for October 14-16 and November 11-13 at the Hotel Astor, New York, will be chaired by **Bernard C. White,** treasurer, Sutherland Paper Co., Kalamazoo, Mich. **A. W. Lansberg,** treasurer and controller, Knox Glass, Inc., Knox, Pa., will be associate chairman. The subject will be "Financial Planning and Control as a Tool for Top Management."

At the special conference of the AMA on "Financial Planning for Greater Profits" on October 14-16 at the Roosevelt Hotel, New York, **James J. Doyle,** director of Finance, the Port of New York Authority, New York, will act as chairman of the afternoon session on the 14th for the discussion of "Establishing Corporate Objectives and Creating the Framework Within Which the Objectives Can Be Attained." Speakers at the morning session on the 16th will be **John H. Goodwin, Jr.,** vice president-finance, Columbus McKinnon Chain Corp., Tonawanda, N. Y., who will discuss "Determining Money Needs" and **Albert M. Norman,** treasurer, L. B. Foster Co., Pittsburgh, Pa., who will speak on "Sources of Money."

Dates Ahead

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28th

ANNUAL NATIONAL CONFERENCE

OCTOBER 25-28 — **PENN-SHERATON HOTEL** — **PITTSBURGH, PA.**

OTHER ORGANIZATIONS

OCTOBER 12-14	SYSTEMS & PROCEDURES ASSOCIATION OF AMERICA 1959 International Systems Meeting	TORONTO
OCTOBER 18-21	INSTITUTE OF NEWSPAPER CONTROLLERS AND FINANCE OFFICERS 12th Annual Meeting	SAN DIEGO
OCTOBER 25-28	AMERICAN INSTITUTE OF CPAs Annual Meeting	SAN FRANCISCO

Current Trends in Depreciation Accounting *(Continued from page 461)*

cial statements, unless generally adopted throughout the country, would likely lead to numerous diverse practices in statement presentation, with consequent confusion in their interpretation.

For example, some companies would be likely to continue to show fixed assets at historical cost. Some other companies would probably establish valuations by use of specific indices while still others would use general price indices or perhaps a combination thereof. Aside from the confusion and possibility of misunderstanding which might be engendered by lack of uniformity in financial reporting, is the question of the impact of a change upon existing contracts. To cite only one example, in the case of a pre-existing bond indenture limiting dividends to accumulated earnings, which measure of determining income would be used?

DEFLATION

Many, both accountants and others, who believe that depreciation should give recognition to current price levels appear to be motivated by conservatism since they point to what they consider an existent inflation of profits.

What will the position of these be in the event we come upon a period of deflation?

Will that same conservatism allow them to accept a determination of income which would be predicated on less than historical cost?

Would bondholders tolerate under conditions of deflation a determination of income that might be less protective than historical cost?

I believe that this possibility should be very carefully considered before we espouse any general change to price-level adjusted depreciation in the determination of income.

MAINTENANCE OF CAPITAL

Much of the argument in favor of current cost depreciation appears to be motivated by the feeling that real capital, i.e., the command over economic goods and services, is subject to possible erosion unless revenues are charged with current cost depreciation in the determination of income. There are two points which I would like to make on this aspect of the problem:

First, since as I believe I have heretofore indicated, current cost depreciation does not provide for replacement, it may lessen but cannot eliminate erosion of the character contemplated.

Second, *does erosion occur to the extent that capital additions are financed by bonds or other types of fixed dollar securities?* It has been said that the method of financing an asset is not relevant to the determination of how it should be depreciated. If this is so, *what is our position to be when we deal with facilities whose use is obtained under long-term lease arrangements?*

These have been availed of to an increasing extent in recent years. Not long ago an instance came to my attention where orders were placed by a company for certain units of equipment some of which were to be purchased and the use of others, identical in nature, was to be obtained by a long-term lease. Leases of this nature bestow upon the company employing a productive facility substantially all the benefits of ownership and entail substantially all the responsibilities of ownership.

In my opinion, which is shared by others, these lease arrangements represent in substance a choice among various available forms of financing. If this be so, *would not the considerations which lead to the feel for need of adjustment of historical cost depreciation also call for some adjustment of changes under long-term leases?* The economic value of a lease and the economic value of property owned are both the present worth of expected future utility. Expressed in dollars both are subject to the same fluctuations of our monetary unit. Yet I cannot envision why protection of proprietary capital would necessitate any adjustment of rental payments. Further, assuming deflation, a downward adjustment of rentals to me is unthinkable. I am led to the conclusion that the form of financing does exert some influence on the need for current cost depreciation.

LIFO

It has been stated that the adoption of the Lifo basis of costing inventories has resulted in the recognition of current inventory costs in the determination of income and that this also is the aim of the use of current cost depreciation. This statement carried with it the suggestion that since this one has been considered acceptable, so should the other. I do not believe this argument has substantial merit. It seems to me that the advocated depreciation change involves a departure from historical cost whereas Lifo does not. As a consequence the problems entailed are of such difference in magnitude that the analogy is of little significance.

From all that has been said and written on this matter of current cost depreciation (and which I have just endeavored briefly to cover), the following thoughts occur to me:

There is general agreement that given a sufficient degree of inflation a basis of accounting other than historical cost would be generally needed, and hence acceptable; that there is equal disagreement on whether or not we have yet reached that point; and that there are many questions of implementation and of consequences to the adoption of current cost depreciation to which further thought should be given.

Until we have arrived at more general acceptance of the need for recognizing price-level changes in the determination of depreciation for purpose of a charge against revenues and until more of the related questions are resolved, it is my opinion that for purposes of presenting the customary formal financial statement, we should adhere to the present concept of income based on historical cost.

In view of the divergencies of opinion on this subject I am in favor of the use, at present, of supplementary information along the lines suggested by the American Institute of Certified Public Accountants and the American Accounting Association. I believe that this supplementary information can be portrayed in various ways.

One possible method which might be appropriate for some companies would be to (a) determine net income on the basis of historical cost depreciation, (b) make an appropriation of net income for the amount by which depreciation based on current dollars exceeds depreciation on

CHANGING YOUR ADDRESS?

Notice of change of address for THE CONTROLLER should be received in the editorial offices of THE CONTROLLER, Two Park Avenue, New York 16, N. Y., before the first of the month to affect the following month's issue. For instance, if you desire the address changed for your December issue, we should be notified of your new address before November 1. *Be sure to include your postal zone as well as your old and new address.*

an historical cost basis, and (c) credit the latter amount to an appropriately designated account in the equity section of the balance sheet.

I am unable to see why the use of supplementary data would not accomplish the objective of those who now feel that basic statements do not furnish the information needed by interested readers under present conditions. It would further meet the desires of the not inconsiderable body which believes that, on balance, conventional statements presently form the more useful basis for reporting corporate income. Possibly even more important, the use of supplementary information is feasible of immediate implementation.

In view of the many allegations concerning the deficiencies of our financial statements and the avowed needs of business for a means of recognizing the effects of inflation, I am considerably surprised that more companies have not availed themselves of the use of this supplementary media of explanation.

DECLINING BALANCE DEPRECIATION

What I have just said leads me to wonder if business ever would really consider adoption of price-level adjusted depreciation until such time as it became also acceptable for purpose of arriving at taxable income. There seems to be an analogy in the case of declining balance depreciation. This method has been acceptable to accountants for many years, yet its use in this country never became at all widespread until the enactment of the Internal Revenue Code of 1954. And, even now many companies which avail themselves of it for tax purposes, continue to report depreciation in their financial statements on the straight-line basis. Since here was a method which would in any event ameliorate the alleged deficiencies of historical cost depreciation, *why has there not been more widespread use of it?*

TAX CONSIDERATIONS

If tax considerations are an important point in the minds of many who advocate the adoption of current cost depreciation for use in the determination of net income, presumably the expectation is that such adoption might lead to some lightening of the corporate tax burden through allowance as a tax deduction of a greater amount of depreciation. It seems to me that this represents a somewhat superficial view of our tax problem which basically is the portion of our national income that is used to support government functions.

If we assume that our over-all tax burden is to remain unchanged, any changes in corporate taxes by reason of a more favorable depreciation deduction would be only a shifting of the total tax burden either as among corporations or between corporation and other groups of taxpayers. Considerations of public policy may call for such shifting; however, I do not believe that this should be a consideration in deciding upon appropriate accounting in a particular area.

REINVESTMENT DEPRECIATION

On this subject of taxes there have been, as you undoubtedly know, proposals for additional capital allowances for tax purposes suggested to the Congress. Some of these have been for the allowance of either replacement basis of depreciation or current cost depreciation. More recently, proposals have been made for an adjustment of depreciation, not on an annual accrual basis, but at the time property is retired and new capital expenditures are made. Briefly stated, in a year in which retirement occurs and capital expenditures are made (with some carry-over allowance) an additional allowance would be granted based upon the percentage excess of a current price index to a similar index in year of acquisition applied to historical cost of the retired assets. This idea has been described as "reinvestment depreciation."

There have been two proposals under this reinvestment depreciation plan. Each would allow a deduction in computing tax of the calculated amount of additional depreciation. In one proposal there would be an outright additional deduction, whereas in the other, the basis of new property would need to be reduced by the amount of the additional deduction. Reinvestment depreciation is primarily concerned with the calculation of taxes rather than financial reporting.

It does, however, raise certain corollary corporate accounting questions (assuming enactment):

First, it does not seem at all unlikely that companies electing to claim reinvestment depreciation will be required also to give recognition to it in their accounts and financial statements. If so, *would the amount thereof (less tax reduction) represent a charge to earnings or earned surplus and a credit to a segregated equity account?* In the event that the additional depreciation must be applied to the tax basis of new property, *could we appropriately follow this treatment for corporate accounting purposes or would any reduction in basis be limited to the tax reduction?*

Second, if recognition in the accounts is not called for, *may the tax reduction be used to increase income or must it otherwise be accounted for?*

The accounting profession should be, and I believe generally is, responsive to the needs and legitimate wishes of the business community. I would like to see the avowed need in this area demonstrated by a more widespread use of the supplementary information to which I have previously referred.

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Active Markets Change Retirement Funds Investment Patterns

THE GENERAL INVESTMENT PATTERN of employe retirement funds continues to change with the times, according to Commerce Clearing House. In its sixth annual survey of the investment position of the funds, it reported that the market value of common stocks held in trustees' portfolios at the end of 1958, a market peak, accounted for 36 per cent of the funds' total assets, a five-point boost over the 1957 year-end valuation.

The annual study summarized reports from a total of 221 companies holding funds having assets with market value of $3.7 billion. The group includes 151 pension plans and 70 profit-sharing plans. Average age of the entire group was a mature ten years.

An analysis of the general investment pattern followed by trustees as of December 31, 1958 was shown in the survey as follows:

	% of Assets	% Change from '57
Corporate Bonds	38%	Down 1 point
Common Stock	36%	Up 5 points
Government Bonds	11%	Down 1 point
Mortgages and Real Estate	5%	No change
Preferred Stock	4%	Down 2 points

"Since the figures are at market value, the high proportion of funds committed to common stocks may merely reflect the 1958 market rise in unrealized appreciation rather than indicating substantial new purchases," the report said, adding:

"Similarly, depression in the government bond market accounted in part for the fact that the lowest percentage of market value yet reported was in governments, but at the same time, it is obvious that there has been switching out of governments over the six-year period of the CCH surveys."

Both government bonds and preferred stock have been losing ground steadily, with the funds thus released going into a variety of more experimental, and presumably higher yielding, investment areas.

Recent developments in the field of pension planning are reflected in these newer investments, the report disclosed. During 1958, nine trusts reported doing some sort of split-funding, with some part of the funds allocated to purchase of life insurance or annuities and the balance in a diversified trust.

Five trusts reported fairly substantial holdings of mutual shares, while two were holding building and loan shares. One of the latter, however, said that this money was being shifted gradually into common stocks.

Another fashionable investment which got some play from trustees in 1958 was in foreign corporations. Four trusts reported holding foreign bonds and stocks. Four others held Canadian Dominion and municipal bonds. World Bank bonds were revealed in one portfolio.

A median yield of four per cent was reported by the 218 trusts which cooperated in the CCH study on this point. As usual, the profit-sharing trusts did best, with 19 funds yielding above seven per cent and only three pension funds yielding that much. None of the trusts reported a net loss in 1958, as several did in 1957, the report said.

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CONTROLLER
ASSISTANT CONTROLLER

B.S., C.P.A., 38, ten years administrative accounting officer of national multiplant manufacturers, five years public accounting. Extensive experience in management reports, budgeting and planning, cost controls, government contract accounting, and procedures. Will relocate. Box 2416.

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